Financial Reporting Council

July 2015

Overview of the financial reporting framework

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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1 Introduction

1.1 As a consequence of the changes to company law arising from the implementation of the EU Accounting Directive, it has been necessary to make amendments to UK and Republic of Ireland (RoI) accounting standards to ensure continued consistency between the revised legal frameworks and the financial reporting framework. This has also given the FRC the opportunity to reconsider the most appropriate way that accounting standards can support the new micro-entities regime.

1.2 The changes to company law predominantly affect the small companies regime, however other more minor amendments affect other aspects of UK and Republic of Ireland accounting standards.

1.3 This overview describes the financial reporting framework that will be applicable for accounting periods beginning on or after 1 January 2016 (early application is permitted subject to the provisions in each standard).

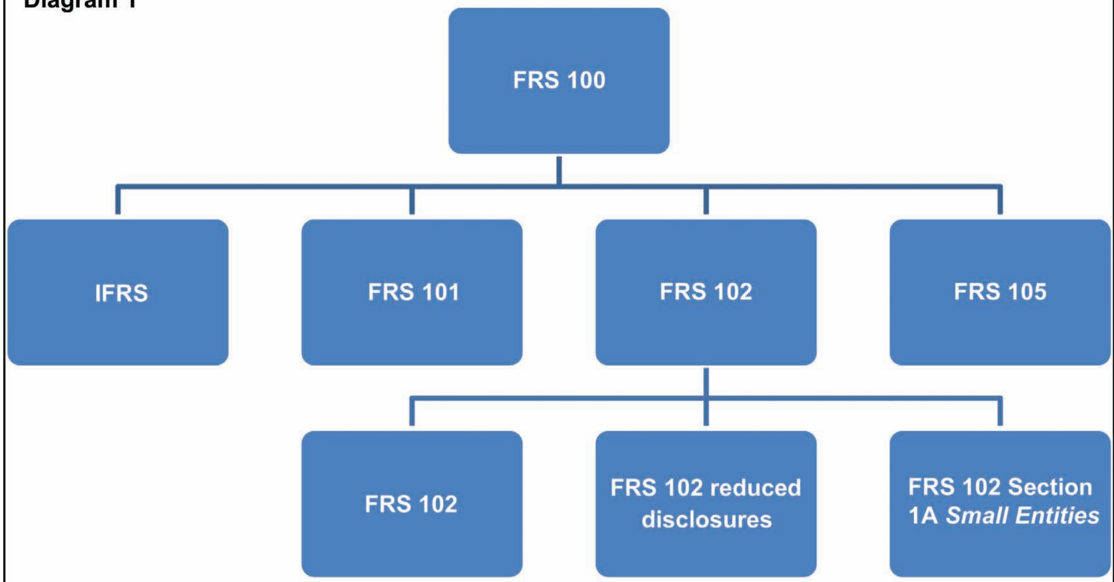
2 The financial reporting framework

2.1 Company law recognises two financial reporting frameworks – IFRS and UK and Ireland GAAP (generally accepted accounting practice).

2.2 Publicly listed companies are required to apply IFRS in the preparation of their group accounts but may choose between IFRS and UK and Ireland GAAP for the preparation of their individual parent accounts. Other entities have a free choice between the two frameworks.

2.3 FRS 100 *Application of Financial Reporting Requirements* sets out the overall framework, which can be illustrated as follows:

Diagram 1



UK and Ireland GAAP

2.4 The UK and Ireland GAAP reporting framework is made up of five regimes, three of which are available within FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. The other two are FRS 101 *Reduced Disclosure Framework* and FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*.

Table 1: UK and Ireland GAAP					
Framework	**Micro-entities regime**	**Small entities regime**	**FRS 102**	**Reduced disclosure framework (FRS 101)**	**Reduced disclosures for subsidiaries and ultimate parents (FRS 102)**
Related accounting standard(s)	FRS 105	Section 1A *Small Entities* of FRS 102	FRS 102	FRS 101	Paragraphs 1.8 to 1.13 of FRS 102

2.5 Smaller entities have a choice between three core UK GAAP regimes subject to meeting relevant criteria:

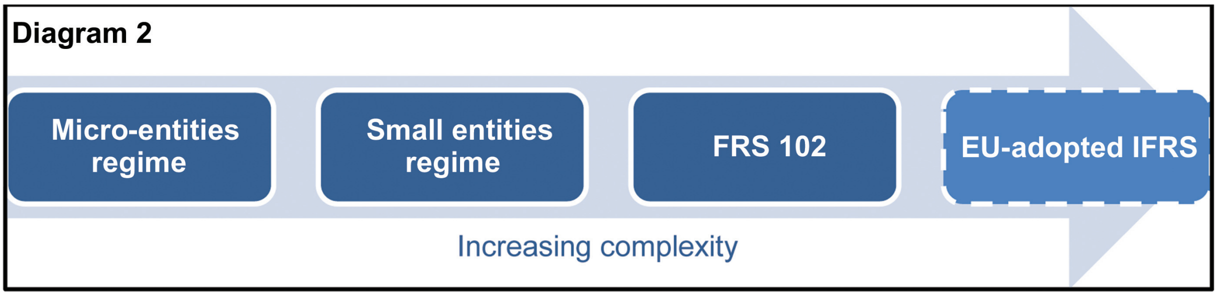
- the micro-entities regime (FRS 105);
- the small entities regime (Section 1A *Small Entities* of FRS 102); and
- FRS 102.

2.6 Entities that are part of a group may apply either of the reduced disclosure regimes. These additional options are discussed in more detail in Section 4 *Additional options for entities that are part of a group*.

The core UK GAAP and Ireland regimes

2.7 The financial reporting requirements of each standard get progressively more complex and comprehensive the further up the suite of standards you go. The increase in complexity correlates to the increasing size and complexity of the entities that are most likely to apply a given standard. In all cases, an entity may choose to opt up to a more comprehensive regime.

Diagram 2



2.8 The selection of which regime to apply will depend on a number of factors including the following:

- Whether an entity is eligible to apply that particular regime. Eligibility criteria may include the type of financial statements (ie individual or group) being prepared, size thresholds and entity type.
- Where a choice of regime exists, entities should consider which of the regimes is the most appropriate to the individual circumstances of the entity. Factors to consider will differ from entity to entity and may relate to certain characteristics or restrictions of a particular regime, the resources available and the information needs of users of the accounts, amongst many others.

2.9 The following table outlines the key eligibility criteria for the micro-entities and small entities regimes. Entities should refer to the detailed eligibility criteria in the relevant legislation in order to determine if they are eligible or not.

Table 2: UK Eligibility criteria		
Regime	**Micro-entities regime**[1]	**Small entities regime**[2]
Source of eligibility criteria	Sections 384A to 384B of the Companies Act 2006.	Sections 382 to 384 of the Companies Act 2006.
Eligible entities	• Companies only (Note: Whilst the legislation and consequently FRS 105 uses the term micro-entities regime, it is only currently available in law to companies.)	• Companies • Limited liability partnerships[3] • Any other type of entity that would have met the criteria of the small companies regime had it been a company incorporated under company law (for example charities)
Size thresholds	A company qualifies if it does not exceed two or more of the following criteria: • Turnover £632,000 • Balance sheet total £312,000 • No. of employees 10	A company[3] qualifies if it does not exceed two or more of the following criteria: • Turnover £10.2m • Balance sheet total £5.1m • No. of employees 50
Ineligible entities	• Any companies excluded from the small companies regime • Financial institutions including credit and insurance institutions • Charities • Small parent companies that choose to prepare group accounts • Companies that are not parent companies but their accounts are included in group accounts	• Public companies • Financial institutions including insurance companies and banking companies

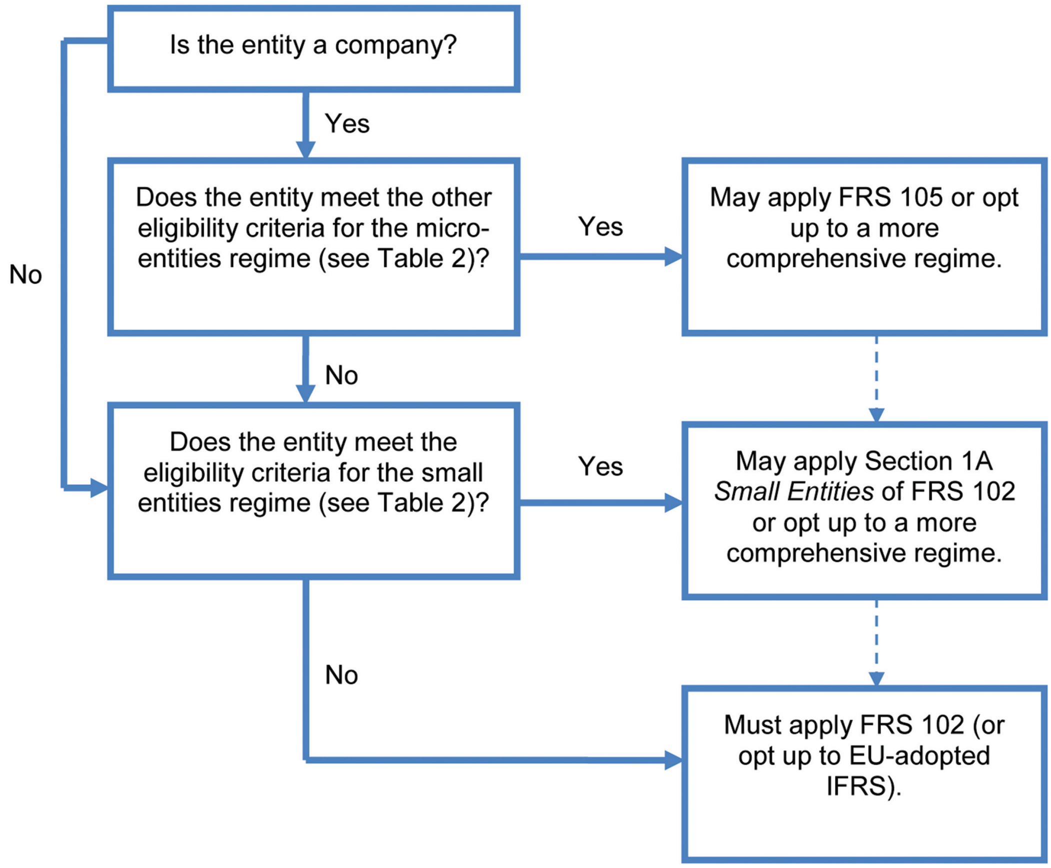
[1] For Irish entities, if legislation is enacted, the equivalent thresholds are: Turnover €700,000, Balance sheet total €350,000 and Number of employees 10.

[2] For Irish entities, qualification as a small company is set out in section 350 of The Companies Act 2014. The current equivalent size criteria are: Turnover not exceeding €8.8m, Balance Sheet total not exceeding €4.4m, and number of employees not exceeding 50. The equivalent thresholds after implementation of the EU Accounting Directive have not yet been set, however the limits in the Directive are: Turnover at or above €8m and not exceeding €12m; Balance sheet total at or above €4m and not exceeding €6m.

[3] As set out in the *The Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008* (SI 2008/1911). The thresholds differ from those applicable to companies.

2.10 The following decision tree will help an entity identify the options that may be open to it in selecting its reporting regime:

Diagram 3: Decision tree



3 Key features of the core UK and Ireland GAAP regimes

FRS 102

3.1 FRS 102 was first issued in March 2013 and is effective for accounting periods beginning on or after 1 January 2015. Subsequent amendments have revised it responding to both issues raised by stakeholders and changes in company law, with the most recent revision being in July 2015. For convenience, a revised edition of FRS 102 will be published periodically to incorporate any recent amendments, usually after any significant amendments have been issued.

3.2 FRS 102 replaced over 70 accounting standards and UITF Abstracts spanning more than 2,400 pages, with one succinct standard of a little over 300 pages. It reflects developments in the way businesses operate and uses up-to-date accounting treatment and language. One of the key improvements in financial reporting is that FRS 102 requires the recognition of financial instruments and disclosure of the risks associated with those instruments. It also improves intellectual mobility and reduces the costs of education and training.

The micro-entities regime (FRS 105)

3.3 Micro-entities are the smallest of entities (with turnover of up to £632,000) and a subset of small entities. The accounting standard for micro-entities, FRS 105, has been developed around the legal framework and simplified the requirements of FRS 102 for this group of entities.

3.4 Although FRS 105 is the least complex standard, every entity that is eligible to apply it should consider whether the regime meets its individual needs. It is important to remember that the micro-entities regime is optional even if an entity meets the eligibility criteria.

3.5 The micro-entities regime requires limited disclosures and constrains the accounting policies that can be applied:

- The only primary statements required are a balance sheet and profit and loss account. There is no requirement to prepare a statement of cash flows, a statement of comprehensive income or a statement of changes in equity. Further, the information presented in the balance sheet and profit and loss account is condensed (for example “fixed assets” is not disaggregated into tangible fixed assets, intangible assets, investment properties etc).
- No assets can be measured at fair value or a revalued amount. This means that land and buildings and investment properties can only be measured at cost and previous revaluations gains would need to be removed on transition.
- Micro-entities’ accounts are **only** required to disclose the following:
  - the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet;
  - an indication of the nature and form of any valuable security which has been provided;
  - the amounts of advances and credits granted to its directors with indications of interest rates, main conditions and any amounts repaid or written off or waived; and
  - any commitments entered into on their behalf by way of guarantees of any kind, with an indication of the total for each category.

- However, micro-entities may voluntarily choose to disclose more information.
- Micro-entities' accounts that comply with the minimal legal requirements are presumed to give a true and fair view. There is no requirement for directors to consider what additional information may be needed in order for the accounts to give a true and fair view.

3.6 In addition to these legal constraints, FRS 105 is simplified further, for example:

- deferred tax and equity-settled share-based payments shall not be recognised; and
- all accounting policy choices have been removed, including the options to capitalise development costs and borrowing costs.

More detailed discussion of the additional simplifications can be found in FRS 105.

Comparison to the FRSSE

3.7 For entities previously applying the FRSSE, Appendix 1 to this document sets out the key differences between that standard and FRS 105. In the majority of instances, the accounting treatment of FRS 105 is either simpler or the same as that of the FRSSE.

The small entities regime (Section 1A *Small Entities* of FRS 102)

3.8 The thresholds for the small entities regime have increased resulting in more entities qualifying as small.

3.9 Similarly to FRS 105, Section 1A *Small Entities* of FRS 102 has been developed around the legal framework from the requirements of FRS 102.

3.10 The requirements of the small entities regime are more comprehensive than the micro-entities regime and the recognition and measurement requirements of Section 1A are the same as those set out in the rest of FRS 102. In relation to recognition and measurement, key differences between the small entities regime and the micro-entities regime include the use of fair value and revaluation accounting and the additional accounting requirements in respect of derivatives, deferred tax and equity-settled share-based payments.

3.11 The law only mandates a limited number of specified disclosures. However, unlike the micro-entities regime, directors of small entities are legally obligated to prepare accounts that give a true and fair view whereas micro-entity accounts are automatically presumed to give a true and fair view if the legal minimum is adhered to. In practical terms this will require more judgement of directors of small entities in considering what additional information (if any) is needed to ensure the accounts give a true and fair view. Section 1A of FRS 102 provides additional guidance to assist directors.

Comparison to the FRSSE

3.12 For entities previously applying the FRSSE, Appendix 2 to this document sets out the key differences between that standard and Section 1A of FRS 102. In the main, the requirements of Section 1A and the FRSSE are the same. However, there are a handful of key differences in accounting treatment between the two standards worth noting, including the recognition of additional financial instruments such as derivatives like interest rate swaps and foreign exchange contracts.

4 Additional options for entities that are part of a group

4.1 For entities that are part of a group and included in the consolidated financial statements (known as qualifying entities), UK and Ireland GAAP provides an additional two further reporting regimes. Both regimes aim to make group reporting more efficient and cost-effective by permitting consistent accounting policies to be applied across a group, but with reduced disclosures.

Table 3: Eligibility criteria

Regime	**Reduced disclosure framework (FRS 101)**	**Reduced disclosures for subsidiaries and ultimate parents (FRS 102)**
Source of eligibility criteria	Definition of a qualifying entity as set out in the glossary to FRS 101.	Definition of a qualifying entity as set out in the glossary to FRS 102.
Eligible entities	A member of a group: • where the parent prepares publicly available consolidated financial statements which are intended to give a true and fair view; and • that is included in the consolidation	A member of a group: • where the parent prepares publicly available consolidated financial statements which are intended to give a true and fair view; and • that is included in the consolidation
Size thresholds	None	None
Ineligible entities	Charities	None

4.2 Each regime is based on a different underlying reporting framework:

- FRS 101 *Reduced Disclosure Framework* is based on EU-adopted IFRS; whereas
- the reduced disclosures for subsidiaries and ultimate parents in FRS 102 are based on FRS 102.

4.3 In essence, entities applying either reduced disclosure regime are required to otherwise apply the underlying requirements of the related standard (ie EU-adopted IFRS or FRS 102) but are permitted to take advantage of certain disclosure exemptions.

4.4 Both reduced disclosure regimes are optional.

Appendix 1
Key differences between FRS 105 and the FRSSE

Table 4: Key differences between FRS 105 and the FRSSE	
Key features of FRS 105:	
Presumed true and fair view	Financial statements prepared in accordance with the legal requirements of the micro-entities regime are presumed to give a true and fair view, therefore directors are not required to consider what additional information is required for the financial statements of the entity to give a true and fair view. This is in contrast to the FRSSE where directors were legally obligated to ensure the financial statements provided a true and fair view.
Preparation of only two primary statements required	Micro-entities are only required to prepare a balance sheet and profit and loss account and not a statement of recognised gains and losses (STRGL) or a cash flow statement.
Significantly condensed formats of statements	The statutory formats for the balance sheet and profit and loss accounts are significantly condensed, for example "current assets" is not disaggregated into stocks, debtors, investments and cash.
Significantly reduced number of disclosures	Micro-entities are only legally required to provide two disclosures, and are not required to provide any more. However, micro-entities can voluntarily provide more disclosures. This is in contrast to the FRSSE which mandates significantly more disclosures.
Simplified accounting treatment	FRS 105 has simplified the accounting treatment for some transactions. For example, micro-entities shall not account for deferred tax.
Fair value and revaluation accounting not permitted	Micro-entities are not permitted to fair value or revalue any assets or liabilities, therefore all assets and liabilities (such as land and buildings and investment properties) must be held at cost. This is in contrast to the FRSSE which permitted or required certain assets to be revalued.
No accounting policy choices	All accounting policy options have been removed. In general, the mandatory treatments result in earlier recognition of income / expenses in the profit and loss account rather than deferring on the balance sheet.
More helpful guidance included	In many instances, the requirements of FRS 105 do not differ from those of the FRSSE, but more guidance is provided in FRS 105 to help preparers apply and interpret the treatment required.
Not all company law requirements are reproduced	FRS 105 does not reproduce all the reporting requirements from company law applicable to micro-entities unlike the FRSSE, but does incorporate those relating to the financial statements. Micro-entities will need to satisfy themselves that they have met all their legal requirements.
Terminology used consistent with FRS 102	FRS 105 uses terminology consistent with FRS 102 such as 'statement of financial position' rather than 'balance sheet'. A table of equivalence is included in Appendix II to FRS 105 for convenience.

Appendix 2
Key differences between Section 1A *Small Entities* of FRS 102 and the FRSSE

Table 5: Key differences between Section 1A of FRS 102 and the FRSSE	
Key features of Section 1A of FRS 102:	
Preparation of only two primary statements required	Small entities are only required to prepare a balance sheet and profit and loss account and not a statement of recognised gains and losses (STRGL) or a cash flow statement.
Reduced number of mandatory disclosures	Small entities are only legally required to provide a limited number of specified disclosures. However, directors of small entities are still required to ensure the financial statements provide a true and fair view and therefore must consider what additional information may be needed to achieve this and provide that information.
More helpful guidance included	In many instances, the requirements of Section 1A of FRS 102 do not differ from those of the FRSSE, however more guidance is provided in FRS 102 to help preparers apply and interpret the treatment required.
Improved reporting for financial instruments	FRS 102 will require recognition of some financial instruments that the FRSSE did not. In particular, small entities will need to recognise derivatives such as options, swaps and forward contracts at fair value.
Removal of contract rate accounting for foreign currency transactions	FRS 102 does not permit the use of contract rate accounting in relation to foreign currency transactions and a small entity must apply the hedge accounting requirements of FRS 102 instead if they wish to achieve similar accounting results.
Deferred tax arising on revaluations	FRS 102 requires small entities to recognise deferred tax arising on revaluations of fixed assets.
Addition of the performance method of accounting for government grants	FRS 102 permits an accounting policy choice between the accruals method (the method mandated in the FRSSE) and the performance method in relation to government grants. The performance method is simpler to apply and may lead to earlier recognition of income in the profit and loss account in some circumstances.
Gains / losses on investment properties recognised in profit or loss	FRS 102 requires that gains and losses on investment properties must be recognised in profit or loss, rather than in reserves as previously required by the FRSSE.
Not all company law requirements are reproduced	Section 1A of FRS 102 does not reproduce all the reporting requirements from company law applicable to small entities unlike the FRSSE, but does include those relating to the financial statements. Small entities will need to satisfy themselves that they have met all their legal requirements.
Terminology used consistent with FRS 102	Section 1A of FRS 102 uses terminology consistent with the rest of FRS 102 such as ‘statement of financial position’ rather than ‘balance sheet’. A table of equivalence is included in Appendix III to FRS 102 for convenience.

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