ACCA

Accounting standards for small entities

Consultation document issued by the Financial Reporting Council (FRC) in September 2014

Comments from ACCA
28 November 2014

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GENERAL COMMENTS

We are generally supportive of the proposed approach in the consultation document (CD).

The proposals for both micro and small companies raise substantial issues in relation to the application of the 'true and fair' concept.

For micro companies some significantly curtailed financial statements are going to be deemed to give a true and fair view. Those financial statements, shorn of the detail and further disclosures, might in some

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cases be misleading. It is not clear in such cases what might be the responsibilities of directors and other professional accountants involved with the financial statements.

For small companies there will again be significantly less information mandated by law and accounting standards. The overriding requirement, however, for accounts to give a true and fair view will remain and therefore the company is obliged to judge what further information is required in order that the accounts give a true and fair view, and add that in. It is not clear how directors and others should approach that issue, and the extent to which accounting standards can implicitly add to the legal minimum disclosures in order that they can assist company directors and others in that decision.

FRC needs to provide such guidance for both groups of companies, and also to review the legal basis of the true and fair requirement in the light of these developments, then consider a revised opinion on the subject.

SPECIFIC COMMENTS

We now comment on the specific questions raised in the CD, as follows:

Q1. Do you agree with the proposal to develop a new accounting standard, the Financial Reporting Standard for Micro-entities

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(FRSME), for entities taking advantage of the micro-entities regime? If not, why not?

We agree with the proposal in general. We are not sure that the proposed title is very appropriate for two reasons. FRSME was an acronym used earlier by the FRC for a different standard. The term "micro-entities" is misleading at present as the FRSME will only be applicable to limited companies.

FRC should, however, try to extend the proposed regime to other kinds of micro-entities such as LLPs, unlimited partnerships and sole traders. There seems no good reason that if simplified accounting is deemed appropriate for micro limited liability companies this should not be available to other similarly sized entities.

The micro regime includes very few disclosure requirements as noted in 2.5(e) of the CD. One of those is for guarantees and financial commitments. In the absence of other more specific requirements, it would be helpful if the FRC were to provide guidance on what sort of matters should be covered by that – for example derivative contracts, leases, and pension commitments.

Q2. Do you agree with the proposed recognition and measurement simplifications that are being considered for the FRSME? If not, why not? Are there further areas where you consider simplifications could be proposed for micro-entities?

We agree with the areas for simplifications proposed.

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In 2.6(b) the simplifications in relation to deferred taxation, share-based payments and defined benefit plans are stated in a permissive way. We note there is no requirement for any disclosure of accounting policies and for any more details of the position on these potentially complex areas. These should therefore in our view be stated as prohibitions, unless appropriate disclosures are provided alerting users to the impact of their application.

Further areas of complexity that the FRC should consider simplifying for micro-entities are in relation to the recognition and measurement of intangible assets.

Q3. Do you agree that the accounting standard for small entities should continue to be applicable to all entities meeting the relevant criteria, not just companies?

Yes. As for micro entities we see no reason for the accounting to be different depending on the legal form of the entity.

Q4. Do you agree that the FRSSE should be withdrawn and small entities should be brought within the scope of FRS102, so that they apply recognition and measurement requirements that are consistent with larger entities, but with fewer mandatory disclosures? If not are there areas where you consider there should be recognition and measurement differences for small entities and why?

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ACCA supports the replacement of the FRSSE in this way and indeed has advocated this with the FRC from the start of the development of the new UK GAAP.

The reductions in the compulsory disclosure requirements and therefore loss of financial information for users, between the current FRSSE and the new version, will be significant and this reflects the impact of the new Accounting Directive's maximum harmonisation approach. This applies even if, as we expect, UK legislation takes up the maximum five 'extra' requirements allowed.

However the overriding obligation for companies to ensure that their financial statements provide a true and fair view remains. As we have noted in our general remarks above, the FRC should consider what sort of guidance is appropriate for directors and others who may have to resolve these potentially conflicting legal requirements.

In addition FRC should consider how the new Standard's disclosure requirements for small entities can be set out in a way which minimises the areas for judgement on further disclosures while remaining within the Directive's requirements. As we have noted under Q1 above, one is an expectation of what should be included under some of the Directive's requirements. For example what should be included in "financial commitments, guarantees and contingencies" in 3.7(d) and of "off balance sheet arrangements" in 3.8(b). Also the Directive in Article 9.2 allows member states to require further subdivision of items in the formats of the P&L and balance sheet. We can see that if the FRC makes effective use of both of these

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opportunities, more of the existing quality of the financial statements may be retained and the erosion of financial information available to users stemmed to some extent.

In terms of recognition and measurement requirements for small entities, the intended approach of following FRS102 without further modification, seems correct. We do not consider this to be unduly onerous, and the experience from the FRSSE and from the application of IFRS for SMEs would tend to support that view. This approach will limit complexity and streamline accounting in UK and Ireland, and will help with the understanding by users of the accounts. It will also for example simplify the education and training for accounting staff. The need for simplification should be reviewed after about two years' experience of the application of the new standard.

It is important that the new standard for small entities is available as soon as possible. The new threshold for the definition of a small company might be available for early application before 2016 and it would be ideal if the new accounting standard were available, for example, to allow a company currently medium-sized to prepare its first financial statements under FRS102 with the benefit of the disclosure reductions for small companies.

Q5. Do you agree, in principle, with adding a new sub-section to Section 34 of FRS102 to address the principles of accounting by residential management companies? If not, do you consider this unnecessary, or would you address this issue in an alternative way?

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We agree with addressing in Section 34 the principles of accounting by RMCs, but only to the extent that they are significantly different from other companies.

Q6. Do you agree that FRS102 should not include all the disclosure requirements for medium and large companies from company law? If not, why not?

We agree. Compliance with disclosure requirements from whatever source is driven in practice by software or disclosure checklists. Companies applying FRS102 will not benefit from having them repeated there.

Q7. Do you agree that FRS101 should be amended to permit the application of the presentation requirements of IAS1 rather than the formats of the profit and loss account and balance sheet that are otherwise specified in company law?

Yes. The flexibility of presentation, while still providing comparable information, will be helpful to subsidiaries in groups that report using IFRS.

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