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For the attention of: Jenny Carter
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30 April 2015

Dear Sir or Madam

FRED 58 *Draft FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime.*

We welcome the opportunity to comment on FRED 58 *Draft FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime* ("FRS 105") and support the FRC's intention to develop a reporting standard for micro-entities derived from the recognition and measurement principles of *FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland* ("FRS 102").

There appears to be a conflict between FRS 105 1.2 which restricts the scope of FRS105 to companies that qualify as micro-entities under Company Law, and paragraph A3.2 of Appendix 3, which states that "the requirements FRS 105 may be appropriate for the preparation of financial information by other reporters of a similar size if appropriate in the circumstances". We consider that it is inappropriate to restrict the scope of FRS 105 to companies. We believe that there are many other entities which meet the micro-entity size criteria and that would benefit from the proposed simplified recognition and measurement requirements. It is clear that the current scope of FRS 105 means that these entities would be obliged to adopt many of the recognition and measurement principles of FRS 102 (or EU-IFRS) to compute their taxable profits, which we feel is unduly onerous. We have seen no rationale for this restriction of the scope of FRS 105, which is inconsistent with the approach adopted for small entities and does not align with the government's commitment to easing the burden on business. Therefore we suggest paragraph 1.2 is amended to extend the scope to other entities that would qualify as micro-entities if they were companies and which are not prevented by other legal or regulatory requirements applicable to the entity from applying FRS 105. We also urge the FRC to consult with HMRC to clarify whether such an extension of the scope of FRS105 would give an acceptable basis for the calculation of taxable profits for micro-entities that are not companies.

In our opinion Section 12 of FRS 105 does not meet the objective of simplifying the application of the standard for preparers and we suggest this is reconsidered. Our detailed comments and suggestions are given in our response to question 4.

Our responses to the consultation questions are given in Appendix 1 to this letter, our detailed comments on FRS 105 are given in Appendix 2, except those on Section 11 which are in Appendix 3.

We are delighted that when the resulting standards or amendments from EDs 58, 59 and 60 are introduced we will have a new UK GAAP that meets the accounting requirements that all entities need in the current business environment. Whilst we recognise that amendments to accord with Company law are needed from time to time we commend the three year review cycle as the basis of future adjustments wherever possible.

We look forward to a harmonised approach for micro, small, medium and large entities from years commencing on or after 1st January 2016.

Yours faithfully

Danielle Stewart OBE
Baker Tilly Tax and Accounting Limited

APPENDIX 1
Responses to the questions

Structure and language of draft FRS 105

Question 1

In adapting FRS 102 to create draft FRS 105, it is necessary to strike a careful balance between developing an accounting standard that:
(a) is easily accessible and understandable for preparers of financial statements of entities of this size; yet
(b) maintains consistency with:
(i) the language and terminology of FRS 102 (where the underlying recognition and measurement requirements of the two standards are the same); and
(ii) the structure (i.e. the section and paragraph numbering) of FRS 102 upon which draft FRS 105 is based.
The advantages of maintaining consistency of structure and language with FRS 102 include:
(a) increasing comparability in financial reporting between entities reporting under different UK accounting standards; and
(b) reducing education and training costs for preparers, advisors, auditors and users of financial statements.

The FRC anticipates that entities that do not expect (or wish) to grow outside the qualifying limits of the micro-entities regime are more likely to favour simplicity of structure and language and will not be concerned with consistency with FRS 102; whereas entities that do expect to grow and move through the different reporting frameworks over time, and practitioners and advisors that have a range of clients reporting under different frameworks, are more likely to favour consistency of structure and language across the suite of UK standards.

Draft FRS 105 has been developed with this consistency in mind and this FRED presents the draft standard such that the language and terminology of FRS 102 (where the underlying recognition and measurement requirements of draft FRS 105 are the same), and the section and paragraph numbering of FRS 102, has been maintained. Those sections and paragraphs that have been deleted (either because of legal compliance (see Question 2) or because further recognition and measurement simplifications have been introduced (see Questions 3 to 8)) are replaced with the term ''[not used]''. Where the recognition and measurement requirements have been simplified in draft FRS 105, this consistency has not necessarily been maintained.

Do you agree with this approach? If not, why not? What alternative presentation do you propose?

We agree with this approach as in our opinion having as consistent as possible a financial reporting framework will promote good quality financial reporting, improve consistency of reporting and comparability between similar entities and assist preparers of financial statements when entities cease to be eligible to use FRS 105 and therefore need to prepare accounts in accordance with FRS 101, FRS 102 or EU-adopted IFRS. However we note that because of simplifications to the recognition and measurement requirements of FRS 102 there are some instances where paragraphs in FRS 105 are not consistent with the paragraphs with the same number in FRS 102, for example 11.15. It would be helpful to preparers, particularly for entities that may be transitioning between FRS 105 and FRS 102, if the numbering of such paragraphs in FRS 105 included something to indicate the inconsistency with FRS 102. Alternatively the alignment of structure with FRS 102 could be limited to section numbers only.

Legal requirements

Question 2

The proposed amendments to align the requirements of draft FRS 105 with company law are discussed in more detail in paragraphs 19 to 31 of the Accounting Council's Advice.

Do you agree that draft FRS 105 accurately reflects the legal requirements and exemptions of the Micro-entities Regime including:
(a) Its scope?
(b) The presentation and formats of financial statements?
(c) The prohibition of the use of the Alternative Accounting Rules and Fair Value Rules? (d) The disclosure exemptions?
If not, why not? What further amendments are required?

We agree that draft FRS105 accurately reflects the legal requirements for companies that are micro-entities. As set out in our response to question 3 we believe micro-entities other than companies should be permitted to adopt FRS 105, where not prohibited by legislation. This would assist preparers of accounts for micro-entities, other than companies, that need to prepare accounts for legislative, regulatory and other purposes – for example in support of tax computations.

Our detailed comments are set out in Appendix 2

Question 3 – Principles for simplifications

The Accounting Council used the following principles in considering whether further simplifications over and above the legal requirements would be appropriate in draft FRS 105:

(a) if the burden of applying the accounting treatment in FRS 102 is not outweighed by the benefits for micro-entities and an alternative, more straightforward, treatment could be identified;

(b) if the lack of detail in the formats of the financial statements and/or supporting disclosures would limit the understanding of the financial information presented; and/or

(c) if transactions occur infrequently amongst micro-entities.

Paragraphs 32 to 35 of the Accounting Council's Advice provide further detail.

Do you agree with these overarching principles and the resulting simplifications proposed in draft FRS 105? If not, why not?

We agree with the principles for simplification. However, in our view FRS 105 should be available for use by all micro-entities, where not prohibited by regulation and not just available to companies. This would be consistent with the application of FRS 102 proposed

Section 1A to all entities and would promote consistency and comparability in financial reporting.

In addition micro-entities that are not companies may be required to prepare accounts which show a true and fair view, or accord with GAAP in computing their taxable profits. We cannot see any reason why such entities should be required to adopt a more complex financial reporting framework such as FRS 102, rather than being permitted to apply FRS 105.

See also our response to question 2.

Our detailed comments are given in Appendix 2

Question 4 – Financial Instruments (Section 11 Basic Financial Instruments and Section 12 Other Financial Instruments Issues)

The micro-entities regime prohibits the subsequent measurement of assets and liabilities at fair value, therefore financial instruments are measured at cost or amortised cost. Draft FRS 105 proposes a number of further simplifications over and above these legal requirements (see Section 11 Basic Financial Instruments).

Paragraphs 44 to 50 of the Accounting Council's Advice provide further details. Do you agree with this approach? If not, why not?
Do you believe further simplifications are necessary for micro-entities? If so, please provide further details.

We agree with the additional simplifications within Section 11. Our detailed comments on this section are set out in Appendix 3.

We strongly recommend that further consideration is given to Section 12 as in our opinion it will be difficult to apply as currently drafted because it is not clear what it is intending to achieve. It is not apparent how impairment might apply in the context of any assets recognised in accordance with this section. For example a purchased option may only be exercised if a certain trigger occurs. Until that happens or the option expires it will not be possible to determine whether the costs of purchasing the option will be recovered. However, it does not seem sensible to recognise an impairment of those costs while it is not known whether it will be beneficial to exercise the option or not just because at the reporting date it would not be.

Equally it is not clear how the economic benefit arising from a contract recognised in accordance with this section could be measured in order to determine whether the contract is onerous. How can having the benefit of certainty over cash flows as a result of an interest rate swap be compared to the additional interest that might be payable if the variable rate that would otherwise be payable falls to below the fixed rate. By how much would it have to fall for the cost to be greater than the benefit of certainty for a micro-entity?

We recommend Section 12 is simplified to require:

- recognition of any material receipts or payments, including transaction costs, that arise on inception of the instrument as a financial asset or financial liability, or if not material, immediately in profit or loss,

- recognition of other cash flows as they become receivable or payable in accordance with the contractual rights and obligations of the contract,
- allocation of any amount initially recognised as a financial asset or financial liability to each reporting period over the life of the contract, and
- derecognition when one or more of the conditions in paragraph 11.33 are met.

In light of our observations and suggestions we have not made any further detailed comments on Section 12. However, we would be happy to provide further comments if it would assist the FRC in finalising this section.

Question 5 – Capitalisation of development costs (Section 18 Intangible Assets other than Goodwill) and borrowing costs (Section 25 Borrowing Costs)

Draft FRS 105 proposes to remove the accounting policy options from FRS 102 in relation to the capitalisation of borrowing costs (Section 25 Borrowing Costs) and development costs (Section 18 Intangible Assets other than Goodwill). The proposed mandatory treatment will be to expense both borrowing and development costs.

Paragraphs 42 to 43 of the Accounting Council's Advice provide further details.

Do you agree with this approach? If not, why not?

We agree with the proposals for the reasons given in paragraphs 42 and 43 of the Accounting Council's Advice.

Question 6 – Government grants (Section 24 Government Grants)

Draft FRS 105 removes the accounting policy option from FRS 102 in relation to the treatment of government grants (Section 24 Government Grants). The proposed mandatory treatment will be to apply the performance method.

Paragraphs 42 to 43 of the Accounting Council's Advice provide further details.
Do you agree with this approach? If not, why not?

We have some reservations about the proposed approach because it is not consistent with the accruals concept and for micro-entities receiving capital grants, will not result in grant income being recognised in profit or loss in the same periods as the expenditure for which it is given. However we support the overall approach of not allowing accounting policy choices for micro-entities for the reasons set out in paragraphs 42 and 43 of the Accounting Council's advice. We recognise that this means a treatment must be mandated. Of the two available approaches the performance model is likely to be the easiest to apply by preparers and understood by users of micro-entity accounts. We also consider it will be relatively rare for micro-entities to receive government grants solely in respect of capital expenditure and therefore we agree the performance model should be the mandatory treatment.

Question 7 – Simplifications via cross-referencing to requirements in FRS 102

There are a number of areas within draft FRS 105 where it is proposed that the detailed requirements for a particular type of transaction are removed but a cross-reference to FRS

102 is inserted for micro-entities that have these types of transactions, on the basis that these types of transactions occur infrequently amongst the majority of micro-entities.

The areas where this approach has been proposed include:

(a) intermediate payment arrangements (Section 9 Consolidated and Separate Financial Statement);
(b) trade and asset acquisitions (Section 19 Business Combinations);
(c) puttable instruments and examples of compound financial instruments (Section 22 Liabilities and Equity);
(d) cash-generating units (Section 27 Impairment of assets); and
e) foreign branches (Section 30 Foreign Currency Translation).

Do you agree with this proposed approach in general, and specifically for these types of transactions? If not, why not? Alternatives would be to reproduce the requirements of FRS 102 within draft FRS 105 or for draft FRS 105 to be silent.

We agree with the approach taken. Our detailed comments are given in Appendix 2

Question 8 – Other simplifications

Do you believe that any further accounting simplifications should be made to draft FRS 105 that would be appropriate for micro-entities? If so, please provide specific details of the simplifications you propose and the reasons why the simplification should be made.

The only area where we believe further simplification would benefit preparers of micro-entity accounts and should be considered is the removal of the requirement to discount provisions from paragraph 21.7 as determining an appropriate pre-tax discount rate can be difficult. This relaxation is unlikely to be detrimental to users of micro-entity accounts as recognising provisions at an undiscounted amount is well understood. It will also promote consistency and comparability between accounts of micro-entities as it removes the requirement to apply judgement in determining when the effect of the time value of money is material.

Our detailed comments are given in Appendix 2

Residents' management companies (FRED 50)

Question 9

The FRC's Consultation Document proposed that a new sub-section is added to Section 34 Specialised Activities of FRS 102 for residents' management companies, setting out requirements that would be developed from the proposals set out in FRED 50 Draft FRC Abstract 1 – Residential Management Companies' Financial Statements.

Only some 32% of respondents to this question agreed with the proposal, with the rest disagreeing (50%) or providing some other response (18%).

The most compelling reasons given for not proceeding with the proposal were that:

(a) the issue is too narrow and industry-specific to be dealt with in an accounting standard and inclusion in Section 34 of FRS 102 would open up the FRC to specific requests that could result in the standard becoming unwieldy and difficult to apply; and

(b) interpretations of law and accounting standards should be issued by other means with a significant number of respondents calling for an alternative solution such as sector-specific guidance developed by the FRC or the development of a Statement of Recommended Practice (SORP) by parties outside of the FRC.

In light of feedback received, the FRC now proposes that a clear statement of the legal position (i.e. that residents' management companies act as principals) should be included in the Accounting Council's Advice to the FRC (see paragraphs 54 to 59 of the Accounting Council's Advice). This clarification of the legal position should reduce the diversity in practice that currently exists because when an entity enters into transactions as a principal, such transactions should be recorded in its accounts.

Do you agree with this approach? If not, why not? What alternative approach do you propose?
We agree with the proposal not to include the accounting requirements in FRS 105 for the reasons set out.

We would question whether it is appropriate to reproduce the legal opinion, even in the Accounting Council's advice, since this is in relation to the contractual arrangements between the RMC and supplier and therefore is relevant to the legal form of that relationship and may not be relevant to the substance for accounting purposes.

Consultation Stage Impact Assessment

Question 10

This FRED is accompanied by a Consultation Stage Impact Assessment. Do you have any comments on the costs or benefits discussed in that assessment?

We have no comments on the impact assessment.

8.9	Refers to disclosures in respect of management, and then advances and credits to members of the administrative, managerial and supervisory bodies. This is terminology taken straight from the EU accounting directive and is not that used in the CA2006 or in FRED 59. The language is not consistent with FRED 59 and could therefore be confusing. We recommend the wording is aligned with that used in FRED 59.
15	In our opinion it would assist preparers if this section were cross referred to other sections of FRS 105 where relevant to the recognition, measurement and disclosure of jointly controlled operations and jointly controlled assets. This would also ensure the disclosure requirements of Sch 1.57 of the Regulations (SI 2008/409) are included where these relate to commitments arising from joint ventures.
15.8	This repeats the requirement set out in 15.1 to refer to Section 11 for the accounting for jointly controlled entities.
16	We suggest not using this section and including a reference to Section 17 as there is no difference between the accounting for investment property and the accounting for any other property, plant and equipment.
17.21	It is not clear why the requirements for determining useful life of an item of property, plant and equipment has not been included in FRS 105. In our opinion this guidance would be useful to preparers of micro-entity accounts.
17.25	It is not clear why the requirement in respect of compensation received from third parties has been removed. This will most commonly arise as a result of insurance claims and is as applicable to micro-entities as to larger entities. Inclusion of this paragraph will assist preparers of micro-entities and reduce the likelihood of inconsistencies in practice.
18.8E	We recommend clarifying that the examples given are not all possible internally developed intangible assets.
18.13	While we recognise such transactions may be rare it is not clear why the treatment for exchange of assets has been removed for intangible assets when it is retained in 17.14 for PPE.
20.10	It would assist preparers of micro-entity accounts if a definition of, or guidance on what is included in, minimum lease payments were given.
21.7	In our opinion removal of the requirement to recognise provisions at present value would assist preparers of micro-entity accounts.
21A.2	We recommend including a numerical example of the measurement of an onerous lease as this would be helpful to preparers.
Section 22	It is not clear why the example of the issuer's accounting for convertible debt has been removed. In our opinion it would helpful to retain this example, although we note there is a cross reference to the example in FRS 102.
22.3A	We suggest including "subject to 22.5(a)" in paragraph 22.3A or otherwise clarifying when an instrument that will result in the settlement in cash or other financial assets in the event of a winding up is classified as equity and when such an instrument is classified as a liability. Otherwise the two paragraphs are contradictory.
23.9	It is not clear why the requirements for accounting for customer loyalty awards have been removed but an example (23A.16 and 17) has been retained in the Appendix. If the removal of the accounting requirements was intended as a simplification for micro-entities then we recommend removing the example. Otherwise we suggest reinstating paragraph 23.9, particularly as the Appendix to Section 23 does not form part of the standard.

23.13	It is not clear why the reference to section 21 for return provisions has been removed as this type of transaction will not be unusual for micro-entities. The estimation is no more difficult than for other provision or the estimation required to apply the percentage of completion method. We recommend including "Where an entity offers a refund if customers find goods faulty or are not satisfied and a reliable estimate of the returns can be made, a provision for returns is recognised in accordance with Section 21."
26.6	In our opinion it would be clearer if the term "vesting period" were replaced with "specified period of service", because this paragraph only deals with vesting that is conditional upon the completion of a period of service, and "vesting period" is undefined.
27.18	It is not clear why the clarification that estimates of future cash flows should not include financing and tax cash flows has been removed when the requirement is to apply a pre-tax discount rate. In our opinion it would assist preparers to reinstate this paragraph.
Glossary	In our opinion it would assist preparers if a definition of current asset were included as this is a term used in the regulatory formats.
Glossary	The definition of significant influence should be in the Glossary, as the definition has been removed from section 14 and "significant influence" is in bold in the Glossary definition of an associate.
Effective date	We note that FRS 105 will be available for use once it is issued and request clarification as to whether it can be applied in financial statements for accounting periods that ended before the date of issue of the standard that have not yet been approved by the directors?
Other	Where relevant each section of FRS 105 refers to the disclosure requirements for micro-entities set out in 8.8. This will be very helpful in assisting preparers of micro-entity accounts. These disclosure requirements also extend to financial commitments, guarantees and contingencies in relation to related parties. Because Section 33 is not used there is a risk this disclosure could be overlooked.

11.13B	We question whether it is necessary to have a separate paragraph on immediate write-off of transaction costs that are not material when this is also stated in 11.14A?
11.14(a)(b)	We recommend combining11.14 (a) and (b) as the measurement is the same for trade investments, preference shares and investment in subsidiaries, associates and jointly controlled entities.
11.15	FRS 102 gives an example of determining amortised cost using the effective interest rate method. Under FRS 105 the calculation is likely to be simpler but we believe it would still be helpful to preparers of accounts of micro-entities if a similar example were provided here showing how interest and transaction costs are dealt with in the amortised cost calculation.
11.15	It would be helpful to users if an example was also included of when the allocation of interest to each period at a constant rate would not result in allocation at the rate of interest applicable under the contract.
11.25(b)	We recommend consideration is given to whether it would be more consistent with the objectives of simplifying the recognition and measurement requirements for micro-entities to amend the requirement for recognising an impairment of a financial asset to situations when the expected receipts from the asset are less than the carrying amount rather than requiring a calculation of present value.