



Grant Thornton

An instinct for growth™

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Dear Ms Carter

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FRED 59 Draft Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Small Entities and other minor amendments

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Financial Reporting Council's (FRC) consultation 'FRED 59 Draft Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Small Entities and other minor amendments'.

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Grant Thornton supports the growth agenda and believes that the application of reason combined with instinct will allow dynamic businesses to unlock their potential for growth.

In our view, small entities that are not micro-entities should be subject to the same recognition and measurement requirements as larger entities reporting under FRS 102. We appreciate the concerns that this will mean that greater use of fair values will be required in the preparation of small entity accounts. However, we believe that any complexity that will be added is manageable and worthwhile for small businesses for two main reasons. Firstly, it will ease the transition process for small businesses that grow into preparing 'full' FRS 102 accounts. Secondly, with the exception of micro-entities that choose to apply FRS 105, this approach will improve comparability of results and financial position between many more entities of different sizes.

Furthermore, the new statutory small companies regime will reduce significantly the extent of mandatory disclosure requirements for small companies. Hence, even if required to apply the same recognition and measurement requirements as larger entities, overall small entities should still find the new regime less burdensome.

Chartered Accountants

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Therefore, we support most of the proposals as set out in FRED 59. However, we have set out specific recommendations where we believe that the revised FRS 102 could be amended in order to help preparers of small entity accounts. Further, we have some specific observations on certain areas of the proposed changes to FRS 102 where the drafting could be improved.

We set out our detailed responses to each of the questions raised in the attached Appendix. Please note that we have commented on FRED 58 and FRED 60 in separate letters.

If you have any questions on our response, or wish us to amplify our comments, please contact Neil Parsons (telephone: 0121 232 5385, email neil.b.parsons@uk.gt.com) or Robert Carroll (telephone: 020 7728 2210, email robert.w.carroll@uk.gt.com).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Mark Cardiff', is positioned above the typed name.

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Reponses to specific questions

Question 1

Do you agree that the proposed Section 1A Small Entities adequately reflects the new small companies regime set out in company law and that the disclosure requirements for small entities are clear? If not, why not and what alternative approach would you propose?

The proposed layout of Section 1A in FRED 59 (the FRED)

In our view the new Section 1A could be drafted in a way that is of more help to the preparers of small entity accounts. As currently drafted we believe that this section could pose a significant challenge to preparers. We believe that the overall layout and the organisation of the detailed requirements could be improved and also be made more clear and concise. Users would also benefit from more application guidance. We set out below our recommendations in order to make the requirements for small entities clearer.

Overall Organisation of Section 1A

We believe that the requirements should be re-organised as follows:

Para	Overview of Requirements	Our recommendations
1A.1 2 and 1A.1 3	Requirement for financial statements to show a true and fair view	This paragraph is critical to the section and should be presented up front immediately following the scope paragraph under the title <i>Requirement for financial statements to show a true and fair view.</i>
1A.9 to 1A.1 1	Information to be presented in the income statement	<p>These requirements should be transferred to a specific appendix (similar in style to the appendix to Section 23 of FRS 102) which supports a smaller new core Section 1A. This appendix should be marked as being an integral part of Section 1A. The current paragraph 1A.3 should then cross refer to this appendix.</p> <p>We suggest that part one of this appendix should then be divided into specific clear sections as follows:</p> <ul style="list-style-type: none"> • Presentation choices (Companies Act, Abridged, IAS 1-based) • Companies Act formats • Abridged profit and loss account • IAS 1 statement of comprehensive income

Para	Overview of Requirements	Our recommendations
1A.5 to 1A.8	Information to be presented in the statement of financial position	<p>These requirements should also be transferred to a specific appendix which supports Section 1A (see above).</p> <p>We suggest that part two of this appendix should then be divided into specific clear sections as follows:</p> <ul style="list-style-type: none"> • Presentation choices (Companies Act, Abridged, IAS 1-based) • Companies Act formats • Abridged balance sheet • IAS 1 statement of financial position
1A.14 to 1A.15	Information to be presented in the notes to the financial statements	These requirements should also be transferred to the above appendix forming a part three of such an appendix. Please see below for our suggestion as to how this third part could be organised.

Detailed requirements

We believe that the particular part of Section 1A that deals with the notes to the financial statements could be made more easy to follow if it is laid out in a more logical order that maps the way that financial statements are prepared.

As noted above we recommend that the notes are shown in an appendix to Section 1A. We also believe that the requirements would be better presented in tabular format as follows with the following columns and sub-sections:

Table 1 – Minimum Required Disclosures for a small entity

Appendix Paragraph Number	Minimum Disclosure Requirements of Company Law	Statutory Reference	Paragraphs of FRS 102 which deal with similar disclosure requirements
	Accounting policies and changes to accounting policies ...		
	Notes supporting profit or loss ...		
	Notes supporting the balance sheet ...		
	Financial instruments ...		
	Financial commitments, guarantees and contingencies ...		
	Advances and credits to directors ...		

Appendix Paragraph Number	Minimum Disclosure Requirements of Company Law	Statutory Reference	Paragraphs of FRS 102 which deal with similar disclosure requirements
	Related party transactions ...		
	Disclosures regarding parent company ...		

Table 2 – Encouraged disclosures for a small entity

Appendix Paragraph Number	Encouraged Disclosures	Paragraphs of FRS 102 which deal with similar disclosure requirements
	...	

Enhanced Guidance

Interaction of the formats of the Act and the requirements of the IFRS for SMEs

We believe that the new Section 1A (and also both Section 4 *Statement of Financial Position and* Section 5 *Statement of Comprehensive Income and Income Statement*) should be supported by additional guidance when an entity adapts the formats in the Small Companies Accounts Regulations (SI 2008/409 – (the revised small regulations)) covering the following as a minimum:

- The acceptability of using the terminology contained in the IFRS for SMEs instead of the terminology used in the revised small regulations (for example using ‘property, plant and equipment’ instead of ‘tangible assets’ and ‘inventories’ instead of ‘stocks’ and so on); and
- Additional guidance on the interaction with the line items required by the Small Companies Regulations and the IFRS for SMEs.

Additional primary statements encouraged

Statement of Changes in Equity

Paragraph 1A.4 encourages a small entity to present a statement of changes in equity.

We believe that a small entity should be encouraged to present either a statement of income and retained earnings or a statement of changes in equity in accordance with Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*. In many cases, small companies would meet the requirements to present a statement of income and retained earnings had they been applying the full FRS 102 requirements so such a presentation should, in our view, be encouraged for small companies if a statement of changes in equity is to be encouraged.

Statement of Comprehensive Income

We believe that where a small entity has other comprehensive income it should also be encouraged to present a statement of comprehensive income in accordance with Section 5 *Statement of Comprehensive Income*.

Statement of Cash Flows

We note that the FRSSE previously encouraged a small entity to present a cash flows statement but FRS 102 will not require a small entity to prepare a statement of cash flows. We recommend that the Accounting Council's advice to the FRC sets out its reasoning as to why such a statement is no longer encouraged going forward.

Specific comments on required disclosures

Related Party Disclosures

We believe that amendments are required to paragraph 1A.14(v) which deals with related party disclosures.

Section 1 of the new paragraph 66 to the revised small regulations states that particulars **may be given** of transactions which the company has entered into with related parties, and must be given if such transactions are **material** and have not been concluded under normal market conditions with:

- a owners holding a participating interest in the company;
- b companies in which the company itself has a participating interest; and
- c the company's directors.

Paragraph 1A.14(v) of the new Section 1A only sets out requirements for a small entity to disclose information on related party transactions that have not been concluded under normal market conditions.

We believe that the FRC should consider extending the requirements of paragraph 1A.14(v) in order to require disclosure all material related party transactions (ie the disclosure should be irrespective of whether or not they are concluded under normal market conditions). We do not see this as being an increase in burden or 'gold-plating' as small entities will in any event need to identify all material related party transactions in order to determine whether any have not been concluded under normal market conditions. If they simply disclosed all such transactions, there would be a potential reduction in burden as they would not then have to establish whether any were not concluded under normal market conditions. We also believe that disclosing all such transactions would meet the legal requirement, ie there would be no need to distinguish between those on market terms and those that are not.

If the FRC does not extend the mandatory disclosure requirement to cover all related party transactions with the parties listed in the revised regulations, we recommend that FRS 102 should permit such disclosure without requiring a distinction to be made between those transactions that have been concluded under normal market conditions and those that have not.

Question 2

In developing these proposals the FRC has applied the principle that there should not be differences between the recognition and measurement requirements applicable to small entities and those applicable to larger entities. This principle has been determined after taking account of the generally positive response to a similar proposal in the Consultation Document.

Do you agree with this principle? If not, why not and what alternative principle or specific exceptions to the principle would you propose?

In our view, small entities that are not micro-entities should be subject to the same recognition and measurement requirements as larger entities reporting under FRS 102.

As noted in our comment letter to you dated 28 November 2014, we appreciate the concerns that this will mean that greater use of fair values will be required in the preparation of small entity accounts but we believe that any complexity added is manageable and worthwhile for the following reasons:

- it will ease the transition process for small entities that grow into preparing 'full' FRS 102 accounts;
- it will improve comparability of financial reporting between entities of different sizes; and
- the benefits of a small entity reporting under the new small companies' regime should in most instances outweigh the additional costs of complying with more complex recognition and measurement rules.

Further, we believe that FRS 102's approach to requiring all financial instruments to be reflected on balance sheet provides management with better information to make better informed decisions.

We are therefore in agreement with the above principle.

Question 3

Do you agree that the transitional provisions in FRS 102 are sufficient for small entities, or have you identified any further areas where transitional provisions should be considered? If so, please provide details.

Section 35 Transition to this FRS

It would be welcome if the FRC would consider including the following additional transitional reliefs for small entities:

<p>Small entities and Section 12 <i>Other Financial Instruments Issues</i></p>	<p>A small entity that is applying Section 1A of FRS 102 would not be required to restate comparatives in order to comply with the recognition and measurement principles of Section 12 <i>Other Financial Instruments Issues</i> when FRS 102 is applied for the first time.</p> <p>A small entity that is taking advantage of this exemption would instead restate its balance sheet at the beginning of the first year of applying FRS 102.</p>
<p>FRSSE reporters and equity-settled share based payments</p>	<p>A small entity that is applying Section 1A of FRS 102 which had previously applied the FRSSE and only disclosed information on equity-settled share based payments (ie not recognising an expense) would not be required to apply Section 26 Share-based Payments to equity-settled share based payments that were granted before the date of beginning of the first period of applying FRS 102 (eg 1 January 2016 for an entity with a 31 December year end that does not adopt the revised standard early).</p>

We believe that these additional transitional reliefs would ease the burden of a small entity applying FRS 102. They would provide an additional reporting period in which a small entity is not required to account for such complex transactions and would also reduce the cost of applying FRS 102 for the first time.

Question 4

Do you agree with the other amendments proposed to FRS 102 for compliance with company law?

If not, why not?

General response

We particularly welcome the amendments in Section 18 *Intangible Assets other than Goodwill* and Section 19 *Business Combinations and Goodwill* in respect of the amortisation period for both goodwill and intangible assets. The five-year limit was one particular area of FRS 102 that was causing much concern and was often being misinterpreted as a default rule.

We agree with the proposed amendments to FRS 102 for compliance with company law other than as outlined below where we have a small number of observations and recommendations.

In the light of these observations, we recommend that in the drafting of the amendments to FRS 102 the FRC uses (where possible) the same wording as the revised company law.

Section 9 Consolidated and Separate Financial Statements**Exemption from Consolidation**

We believe that paragraphs 9.3(b), (bA), (d) and (dA) should be redrafted in order for the requirements to be more easily understood and also to follow as closely as possible the relevant wordings in sections 400 and 401 of the Companies Act 2006.

Further, paragraph 9.3(e) should be reworded as the first sentence does not make grammatical sense because it is missing the word “and” and the wording “exempt from being ineligible” will create confusion for users.

We recommend that paragraph 9.3(e) reads as follows:

A parent is exempt from the following requirements to prepared consolidated financial statements on any of the following grounds:

- (e)(i) The parent, and the group headed by it, qualify as small as set out in section 383 of the Act and the group is not ineligible as set out in section 384 of the Act; or
- (e)(ii) The parent would be subject to the small companies regime but for being a public company that is not a traded company.

Section 19 Business Combinations and Goodwill and Section 34 Specialised Activities**Merger accounting and group reconstructions and PBE combinations**

Following amendment paragraph PBE 34.80 of FRS 102 now states:

“Unless it is not permitted by the statutory framework under which a public benefit entity reports, an entity combination that is a merger shall apply merger accounting as prescribed below. If merger accounting is not permitted an entity combination shall be accounted for as an acquisition in accordance with Section 19.”

We note that the above is consistent with the revised regulations.

When a public benefit entity (PBE) is incorporated under the Act it will no longer be able to apply merger accounting principles other than where the combination is a group reconstruction.

When a PBE is established under a statutory framework that permits merger accounting it is possible that a particular combination would be accounted for as a merger but if that PBE were instead incorporated under the Act that same combination would be accounted for as an acquisition.

This could mean that the same type of combination could be accounted for differently just by virtue of the framework in which a PBE is incorporated.

The EU Accounting Directive does not specifically apply to not for profit entities (including charitable companies) so it is possible for legislation to be amended to permit charitable companies to use merger accounting in wider situations than a non-charitable company.

We encourage the FRC to liaise with BIS in order to maintain the ability for charitable companies to continue to apply merger accounting in the situations that were previously permitted under FRS 102.

Section 21 Provisions and Contingencies

Provisions, contingent liabilities and contingent assets – prejudicial disclosures

FRED 59 proposes to delete paragraph 21.17 of FRS 102. That paragraph currently permits, in extremely rare cases, an entity not to disclose some or all information required by Section 21 of FRS 102 in respect of contingent assets, contingent liabilities or provisions where such information can be expected to prejudice seriously the position of the entity in a dispute with other parties. Instead it allows disclosure of the general nature of a dispute, together with the fact, and the reason why, the information has not been disclosed.

The reason for the deletion of this paragraph is not addressed in the Accounting Council's advice in FRED 59 but we understand that this deletion has been proposed as a result of the requirements of Company Law.

Because the above amendment to FRS 102 has been made as a consequence of the requirements of Company Law, we believe that the subject of the amendment is also relevant to FRS 101 and we have commented on this in our response to FRED 60. We do not agree with the proposed deletion but recommend instead that paragraph 21.17 of FRS 102 is amended to read as follows:

“In extremely rare cases, disclosure of some or all of the information required by paragraphs 21.14 to 21.16 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, unless its disclosure is required by law, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.”

We also recommend that the appendix note on legal requirements to FRS 102 explains the legal basis for the above suggested amendment.

Following the above amendment, FRS 102 would contain a disclosure requirement that is consistent with paragraph 97 of FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* as issued in September 1998.

Additional comments

Section 1 Scope

Equivalent disclosures included in the consolidated financial statements of the group and intra-group balances and application under FRS 102

Paragraphs 1.8 and 1.12(d) of FRS 102 exempt a qualifying entity that is not a financial institution from disclosing information on financial instruments provided that equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated. However, when financial instruments are measured at fair value, disclosures are required by the regulations.

Intra-group balances are financial instruments. Intra-group balances will mostly be recorded as basic financial instruments. A group company might enter into a derivative transaction with a fellow group company, for example as part of a group treasury arrangement. Such an instrument would not meet the definition of basic and would be recorded at fair value.

FRS 100.AG8 provides guidance in determining whether the consolidated financial statements of a parent provide disclosures which are equivalent to IFRS.

On the basis that the consolidation process requires the full elimination of intra-group balances, a set of consolidated financial statements used to determine equivalence will not include disclosures that are relevant to intra-group balances.

It therefore appears necessary in such cases for a set of financial statements prepared by a qualifying entity using the reduced disclosure provisions of FRS 102 to include the disclosures as required by Section 11 *Basic Financial Instruments*.

We believe that, unless the regulations require disclosure (for example in some instances where a qualifying entity is party to a transaction with fellow group company that is measured at fair value), FRS 100 and FRS 102 should be amended such that a qualifying entity is not required to disclose information otherwise required by Section 11 *Basic Financial Instruments* in respect of intra-group balances that have been eliminated in the consolidated financial statements of the group in which the parent is consolidated unless required by law.

Whilst not directly relevant to this consultation, we believe that this is an important matter which requires clarification as a matter of urgency.

Other minor observations

Draft Amendments to Appendix I: Glossary

FRED 59 proposes to include a definition of non-current assets in the Appendix I: Glossary. The proposed definition includes a double negative which could cause confusion. We therefore recommend a minor amendment to the definition of non-current assets as noted below.

non-current assets	<p>Assets of the entity which:</p> <p>(a) it does not expect to realise, or intend to sell or consume, in its normal operating cycle;</p> <p>(b) it does not hold primarily for the purpose of trading;</p> <p>(c) it does not expect to realise within 12 months after the reporting period; nor</p> <p>(d) are cash or cash equivalents unless the assets are restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.</p>
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Question 5

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 Consultation Stage Impact Assessment which accompanies FRED 59.