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Dear Ms Carter

Accounting standards for small entities

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Financial Reporting Council's (FRC) consultation on the accounting standards for small entities in respect of the implementation of the EU Accounting Directive.

Grant Thornton UK LLP is a leading financial and business adviser with offices in 26 locations nationwide and more than 25,000 individual and 15,000 corporate and institutional clients. The Grant Thornton global organisation is one of the world's leading organisations of independent assurance, tax and advisory firms. Grant Thornton member firms operate in over 100 countries.

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.

We therefore support the FRC's overall approach to implementing the EU Accounting Directive prioritising the need for accounting standards in the UK to reflect properly the needs of a wide range of users of financial information whilst ensuring that the burden imposed on business, and smaller companies in particular, is both necessary and appropriate.

This approach will help to ensure that smaller companies are able to remain competitive and increase comparability with their European counterparts, which in turn will support growth and the contribution to economic prosperity through the creation of employment opportunities. However, at the same time, the UK's financial reporting framework must also continue to provide high quality information for members and third parties such as creditors, shareholders and regulators.

In particular, we support the proposal to develop a new accounting standard for micro-entities and, in general, we agree with the proposed recognition and measurement simplifications that are being considered in this new accounting standard. In addition, we support the proposal to withdraw the Financial Reporting Standard for Smaller Entities (FRSSE) and for small entities to be brought within the scope of FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.

In our view, small entities that are not micros 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, it will improve comparability between 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.

We agree that FRS 101 Reduced Disclosure Framework should be amended to permit the application of the presentation requirements of IAS 1 Presentation of Financial Statements. This will make FRS 101 a much more attractive option and increase the efficiency and reduce costs of financial reporting within groups.

We agree that the FRC should provide guidance on applying the true and fair concept to small entity accounts, in particular with regard to the general need to provide additional disclosure if necessary to give a true and fair view. However, the true and fair concept is not a different concept for small entities compared to larger entities and the FRC has put out several documents on true and fair in recent years. Therefore, in our view the guidance in FRS 102 should be limited to:

- drawing attention to the directors' duty not to approve accounts unless they are satisfied that they give a true and fair view, and
- explaining that in reaching their conclusion directors should consider whether any additional disclosures in FRS 102 that are applicable to larger entities are required in order for the accounts to give a true and fair view.

Separately, some form of consolidation of existing FRC guidance on true and fair into a single source of guidance (without adding anything new) might be useful.

We set out our detailed responses to each of the questions raised in the attached Appendix.

If you have any questions on our response, or wish us to amplify our comments, please contact David Rice (telephone: 020 7728 2591, email david.f.rice@uk.gt.com) or Robert Carroll (telephone: 020 7728 2210, email robert.w.carroll@uk.gt.com).

Yours sincerely

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Response to specific questions

Question 1 - Do you agree with the proposal to develop a new accounting standard, the Financial Reporting Standard for Micro-entities (FRSME), for entities taking advantage of the micro-entities regime (see paragraph 2.4)? If not, why not?

Yes, we agree with the proposal to develop a new accounting standard for micro-entities. In our view, this approach is the most appropriate because of the different measurement and presentation requirements of micro-entities compared to other entities. Furthermore, we understand that the FRC is now considering the title 'FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime'. We agree this is a more appropriate title for the proposed standard as it continues with the 'new UK GAAP' accounting standard sequence.

Question 2 - Do you agree with the proposed recognition and measurement simplifications that are being considered for the FRSME (see paragraph 2.6(b))? If not, why not? Are there any further areas where you consider simplifications could be proposed for micro-entities?

Yes, we agree with the proposed recognition and measurement simplifications for micro-entities.

We do not consider there are any further areas where simplifications could be proposed for micro-entities, other than to consider whether there is any scope to use a net proceeds approach for the initial measurement of financial assets and financial liabilities. We note that micro-entities will often have loans from related parties such as owners or other family members on non-commercial terms and a net proceeds approach would obviate the need for initial measurement at fair value. However, we do also note that in many instances such loans are repayable on demand, in which case initial measurement of a financial liability would not be an issue. This is because in such cases the fair value of the financial liability is not less than the amount payable on demand, which often equates to the initial proceeds received. If a net proceeds approach were to be applied to financial assets, we note that some changes would need to be made to the impairment model for financial assets.

We would like to emphasise that we believe the simplification to accounting for post-employment benefits in paragraph 2.6(b)(iv) should be made optional for micro-entities. This is because the recognition of a liability for contributions payable arising from an agreement to fund a deficit in relation to past service generally will result in the recognition of larger liability than an accounting measure of a deficit under FRS 102. If this simplification were made mandatory, it could put micro-entities at a commercial disadvantage whereas, if micro-entities have the option to apply FRS 102 accounting for defined benefit schemes they need not be at such a disadvantage.

Question 3 - The accounting standard that is applicable to small entities (not just small companies) (ie currently the FRSSE) is being revised following changes to company law. Company law, which will limit the disclosures that can be made mandatory, may not apply to entities that are not companies. 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? This will have the effect of reducing the number of mandatory disclosures for all small entities, not just small companies (see paragraph 3.11). If not, why not?

Yes, for reasons set out in paragraph 3.11, we agree that the accounting standard for small entities should continue to be applicable to all entities meeting the relevant criteria.

Question 4 - Do you agree that the FRSSE should be withdrawn and small entities should be brought within the scope of FRS 102, so that they apply recognition and measurement requirements that are consistent with larger entities, but with fewer mandatory disclosures (see paragraph 3.15)? If not, are there any areas where you consider there should be recognition and measurement differences for small entities and why?

Yes, we agree that the FRSSE should be withdrawn and small entities should be brought within the scope of FRS 102. In our view, small entities should be subject to the same recognition and measurement requirements as larger entities reporting under FRS 102. We are of this view for a number of reasons:

- When the FRSSE was originally developed it was never the intention for its recognition and measurement requirements to grow apart from 'full' UK GAAP
- FRSSE entities were always required to look to 'full' UK GAAP to determine the appropriate accounting treatment for a transaction that was not specifically dealt with in the FRSSE
- The majority of entities that currently qualify as small will qualify as micro-entities under the new regime and thus be exempted from FRS 102. Hence, it will only be the 'larger' of the current small entities category that will be subject to the requirements of FRS 102
- The 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 companies, overall small companies should still find the new regime less burdensome
- There are only two major areas where the recognition and measurement requirements of FRS 102 are different to the current FRSSE, being the treatment of equity-settled share based payments and the requirement to recognise non-basic financial instruments on balance sheet at fair value through profit or loss.

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, it will improve comparability between entities that are of a different size. This comparability may give rise to wider business benefits, such as improving a small business's ability to compete with larger businesses for finance. This is because providers of finance will be able to compare a small entity to a larger entity, knowing that both sets of accounts have been prepared using the same recognition and measurement requirements.

Furthermore fair valuing derivatives, such as commonly used interest swaps, will help management focus on the current economic attributes of the particular transaction entered into and help stakeholders understand the extent of an entity's potential exposure to such derivative financial instruments.

Whilst we support the alignment of recognition and measurement requirements, we also acknowledge that small entities will be subject to a very short timeline to prepare for such significant changes. Specifically, we note that it is unfortunate that the transition date will have passed by the time a final standard is issued and that the alignment will require small entities to undergo a similar transition exercise to larger entities which have had far longer to consider the implications of making transition to FRS 102. It will, therefore, be important for the FRC to carefully consider what transition relief should be made available to small entities. In addition, to alleviate concerns, educational material should be developed to help preparers of small entity accounts become more comfortable with the changes that will need to be made and how to go about obtaining the necessary valuations of financial instruments.

Question 5 - FRED 50 Draft FRC Abstract 1 – Residential Management Companies' Financial Statements was issued in August 2013. After considering the comments received, the FRC publicised its intention to roll this project into the work required to implement the new EU Accounting Directive. Do you agree, in principle, with adding a new subsection to Section 34 Specialised Activities of FRS 102 to address the principles of accounting by residential management companies (RMCs) (see paragraph 3.27)? If not, do you consider this unnecessary, or would you address the issue in an alternative way?

No, we do not agree that a new subsection should be added to Section 34 to address the principles of accounting for RMCs. We do not believe that FRS 102 should be concerned with such narrow, industry specific issues. Furthermore, most RMCs will be micro-entities. For this reason, we recommend a clear statement of the legal position that RMCs are principals not agents be included in the legal appendix to the proposed micro-entities standard.

Question 6 - FRS 102 does not currently include all of the disclosures specified in company law. Other than in relation to the new small companies regime within FRS 102, it is not proposed that this will change. Do you agree that FRS 102 should not include all the disclosure requirements for medium and large companies from company law (see paragraph 4.6)? If not, why not?

It is not clear from paragraph 4.6 why the FRC has decided that it is not necessary to include additional company law disclosures in FRS 102. At present preparers are required to refer to various sections in the Companies Act and to various schedules in the Accounts Regulations to ensure compliance with any relevant legal disclosure requirements. Therefore, from the perspective of a preparer having all disclosure requirements in one place would make accounts preparation easier and less time consuming. In saying this we do, however, appreciate that there are downsides. FRS 102 would need to be updated as and when company law disclosures are amended and may appear to become 'cluttered'. Nevertheless, for the reasons given above, incorporating company law disclosures into FRS 102 may be something that the FRC should consider further.

Question 7 - Do you agree that, if UK and Irish company law is sufficiently flexible, FRS 101 should be amended to permit the application of the

presentation requirements of IAS 1 Presentation of Financial Statements, rather than the formats of the profit and loss account and balance sheet that are otherwise specified in company law (see paragraph 5.4)? Do you agree that this will increase efficiency of financial reporting within groups? If not, why not? Do you foresee any downsides to this approach?

We agree that, whilst the law should allow for alternative formats, accounting standards should address the detail. We, therefore, agree that if company law is sufficiently flexible, FRS 101 should be amended to permit the application of the presentation requirements of IAS 1.

We believe this would make FRS 101 much more straightforward to apply, in particular as many entities for which FRS 101 would be of particular use report their financial information to their parent for consolidation purposes on the basis of IFRS. It would also make FRS 101 more attractive to parent companies that prepare their group accounts under IFRS. This is because overall consistency of presentation of the parent's separate financial statements could be achieved without having to present full IFRS disclosures for the parent individually, which often add little value to the annual report and accounts taken as a whole.

We are aware that, where alternative presentation is permitted by the EU Directives, the information given must be at least equivalent to that required under the formats. This may mean that alternative presentations cannot achieve full alignment with IFRS in all cases, for example for the presentation of discontinued operations where IFRS 5 Non-current Assets Held for Sale and Discontinued Operations is in point. However, in our view such issues should affect only a minority of companies adopting FRS 101 and could be managed by FRS 101 making minor adaptations to IAS 1 in those limited cases where an inconsistency arises. We further note that the Accounting Directive uses the term "equivalent" and see no reason why a similar interpretation to that set out in the Application Guidance in FRS 100 could not be applied in this context, meaning that strict compliance with every point in the Directive formats would not be necessary.

Other matters

Should the FRC develop guidance on applying the true and fair concept to small company accounts, in particular with regard to the general need to provide additional disclosure if necessary to give a true and fair view?

Until now, directors have been able to apply the disclosure requirements set out in accounting standards and, in most cases, achieve a true and fair view by so doing. The statutory curtailment of small company disclosure requirements, including those in accounting standards, whilst retaining the requirement to include additional disclosures if necessary to achieve a true and fair view, will put more pressure on directors in making judgements about accounts disclosure. In the absence of further guidance, directors may be ill-equipped to make their judgements and may even be at risk of legal challenge as to whether they have discharged their duties properly.

In addition, per the Department for Business, Innovation and Skills (BIS) consultation on the Accounting Directive, the audit thresholds may not be matched to the small accounting thresholds. If this were to happen, whilst the directors' judgement is the first judgement to be made, there would be more pressure on auditors of companies that fall between the auditing and small accounting thresholds to opine on whether accounts give a true and fair view. This contrasts with the current situation where, although auditors must consider the overall truth and fairness of the financial statements, they can generally rely on the disclosure requirements in the accounting standards to help them form a conclusion on whether the accounts give a true and fair view.

Therefore, for the reasons set out above, in our view the proposed new Section 1A of FRS 102 should draw attention to the directors' duty not to approve accounts unless they are satisfied that they give a true and fair view. In addition, the new Section 1A of FRS 102 should explain that in reaching their conclusion directors should consider whether any additional disclosures in FRS 102 are required in order for the accounts to give a true and fair view. Separately, the FRC has put out several documents on true and fair in recent years and some form of consolidation into a single source of guidance (without adding anything new) would be useful.

Abbreviated accounts for shareholders of small companies
We note that BIS is considering taking up the option in the Accounting Directive to permit small companies to prepare abbreviated accounts for their shareholders. Such accounts would still be required to show a true and fair view and additional disclosures may be necessary to achieve this. We observe that as such accounts would be intended to give a true and fair view, accounting standards would apply to them. We therefore see no reason why the FRC should not be able to set accounting standards that require disclosure or presentation in addition to any legal minimum specified for abbreviated accounts within the overall constraint that accounting standards are not permitted to add to presentation or disclosure requirements set out in the Directive for full small company accounts.

Amendments to FRS 102 due to changes to the Accounting Directive
We note that other changes will need to be made to FRS 101 and FRS 102 as a result of changes to the Accounting Directives.

Useful life of goodwill
We are aware that the under FRS 102 the current five-year maximum useful life of goodwill and intangible assets, where no reliable estimate of useful life can be made, is being read widely as the default rule rather than the exception.

We understand that the FRC, in line with changes to the Accounts Directives, is considering changing FRS 102 to increase this maximum useful life to 10 years. When amending FRS 102, we recommend that the FRC adopt wording along the lines of that used in the EU Accounting Directive so as to make it clear that it is only in exceptional circumstances that the useful life of goodwill and intangible assets cannot be reliably estimated and that reliable estimation is usually possible.

Financial instruments at fair value through profit or loss
We observe that the fixed 5 September 2006 date for cross referring to EU-adopted IFRS is not in the new Accounting Directive. This means that the disclosures required of financial instruments at fair value through profit or loss will be those from EU-adopted IFRS applicable at the reporting date. We note that the Accounting Directive change will affect the financial instruments that may be carried on a fair value basis. This should enable some of the adjustments made by FRS 101 to EU-adopted IFRS for legal reasons to be removed. We also note that the change would permit financial liabilities for contingent consideration arising on a business combination to be carried at fair value through profit or loss, which would enable the FRC to remove one of the modifications to IFRS currently included in FRS 101. This would also open up the possibility of amending the approach to business combinations in FRS 102 to align more closely with IFRS 3 (Revised 2008). However, we suggest that this be considered as part of the first three-yearly review of FRS 102.

The new Accounting Directive permits the equity method for investment in subsidiaries, associates and joint ventures to be applied in individual accounts. Assuming that this option is taken up in UK law, we recommend that the approach should be permitted by FRS 101 but believe that the FRC should consult further on whether to permit it under FRS 102.

In summary, we recommend that the FRC consult on whether changes that were made to FRS 102, and adaptations of IFRS made by FRS 101, to accommodate the law as it stood when those standards were issued should be modified. In this regard, we note that the FRC's objective is to develop standards that have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective of enabling users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.