Deloitte LLP
2 New Street Square
London
EC4A 3BZ

Tel: +44 (0) 20 7936 3000
Fax: +44 (0) 20 7583 1198
www.deloitte.co.uk

Direct: 0207 007 0884
Direct fax: 020 7007 0158
vepoole@deloitte.co.uk

Jenny Carter
Financial Reporting Council
8th Floor
125 London Wall
London EC2Y 5AS
By email to: ukfrs@frc.org.uk

28 November 2014

Dear Ms Carter

Consultation Document: Accounting Standards for Small Entities

Deloitte LLP is pleased to respond to the consultation paper addressing changes to accounting standards for small entities ("the consultation") as a result of the UK implementation of the EU Accounting Directive: Chapters 1-9 ("the Directive"). We have set out our detailed responses to the consultation questions in the Appendix to this letter.

Overall we support the proposals. Our key comments, which we expand on in the Appendix to this letter, are as follows:

- we believe that, since compliance with UK accounting standards is generally accepted as being necessary to give a true and fair view, the role of UK accounting standards will be significant under the new regime in guiding directors of small companies as to whether further disclosures may be necessary, in addition to those mandated by law, in order to present true and fair accounts;

- we agree that a new accounting standard for micro-entities should be developed;

- we agree that the FRSSE should be withdrawn and that small entities (other than micro-entities) should be brought within the scope of FRS 102;

- we strongly support the provision of increased flexibility in the layout of primary statements, particularly to accommodate the application of IFRS layouts and terminology for companies adopting FRS 101; and

- we recommend that the Financial Reporting Council (FRC) work closely with the Department for Business, Innovation and Skills (BIS) to make the new regime available to companies as soon as possible, including permitting early adoption.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Anne Cowley (0207 303 8361 or ancowley@deloitte.co.uk) or Ken Rigelsford (0207 007 0752 or krigelsford@deloitte.co.uk).

Yours sincerely

Veronica Poole
National Head of Accounting and Corporate Reporting
Deloitte LLP

Deloitte.

Appendix

Responses to detailed 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, although to avoid confusion with previous exposure drafts, we recommend that it be given a name consistent with those issued to date, i.e. FRS 10X The Financial Reporting Standard for Micro-entities.

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. However, we note that paragraph 2.6(b) is not a complete list of recognition and measurement simplifications (for instance, the removal of the option to apply the Alternative Accounting Rules or Fair Value Accounting Rules is given in 2.5(d) rather than 2.6(b)). Accordingly we believe it would be helpful for the FRC to publish an exposure draft of the new standard as soon as possible so that the full extent of the changes can be clearly understood.

We suggest that Section 9 *Consolidated and Separate Financial Statements* and Section 19 *Business Combinations* could additionally be removed from the FRSME as these will not be relevant to micro-entities.

Question 3 The accounting standard that is applicable to small entities (not just small companies) (i.e. 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?

We agree that the requirements set out for small entities in accounting standards should apply to all entities, not just companies. In most cases such entities will be subject either to additional legal requirements or the requirements of a SORP. Accordingly we recommend that SORP-making bodies consider whether this change may prompt them to amend their SORPs to require additional disclosures where relevant.

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. The majority of small entities also qualify as micro-entities and will therefore be eligible to apply the FRSME. Although we acknowledge that this is likely to prove challenging in the short term for those small entities that engage in more complex transactions (including accounting for financial instruments and equity-settled share-based payments) and do not qualify for the micro-entity regime, we consider that the benefits of transparency, consistency and comparability outweigh the short-term challenges for those affected.

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 with the proposed approach. Although we acknowledge that there exists diversity in practice in this area, we believe that the benefit of introducing a clear requirement in this area would not outweigh the cost of doing so, particularly since the majority of RMCs would be expected to qualify as micro-entities. We believe that the best course of action would be for the FRC to publish the legal opinion that it has obtained in relation to RMCs, and to permit RMCs to apply judgement in selecting the accounting treatment that is most appropriate to their circumstances.

In any case, we believe that it is not appropriate to consider this issue at this juncture but rather to address it as part of the first three-year review of FRS 102.

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?

Yes, we agree. Although we acknowledge the usefulness of a 'one stop shop' for small entities, the requirements in law for large and medium-sized companies are lengthier and would lead to a longer and more complicated accounting standard.

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 FRS 101 should permit application of the presentation requirements of IAS 1 and that this would increase efficiency of financial reporting within groups. We do not foresee any downsides to this approach.

One of the most significant obstacles to adoption of FRS 101 by UK companies has been the challenge of reconciling IFRS requirements with the relatively inflexible requirements of company law. In particular, the distinction between "fixed and current assets" versus "non-current and current assets" has been problematic.

In our response to the consultation *UK Implementation of the EU Accounting Directive: Chapters 1-9*, published by BIS on 29 August 2014, we recommend implementation of Articles 11 and 13(2) of the

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Directive. For example, Article 11 could be implemented by stating in regulations that companies may present items on the basis of a distinction between current and non-current items in a different layout from that set out in the prescribed formats provided that the information given is at least equivalent to that otherwise to be provided by those formats.

This is far preferable to an approach which would attempt to define an 'IFRS format' for inclusion in the regulations, given that IAS 1 merely specifies the minimum contents of the primary statements and provides flexibility about the description of items and the layout. If this suggestion is taken up, we suggest that the FRC could usefully develop guidance on the meaning of 'equivalent' in this context and that any further limitations on the acceptable use of this flexibility should then be specified in accounting standards.

We also recommend consideration as to whether the use of this flexibility should be limited to companies applying FRS 101 or whether it could also be available to (and useful for) those applying FRS 102.

Additional comments

Status of accounting standards

We believe that the role of UK accounting standards will be significant under the new regime for small companies. Although we understand that the Directive does not permit member states to require further statutory disclosures to be made beyond those included in the Directive, accounts prepared by small companies must continue to present a true and fair view under the new regime. In its recent consultation *UK Implementation of the EU Accounting Directive: Chapters 1-9*, published on 29 August 2014, BIS acknowledged that the statutory disclosures prescribed by the Directive will not address this requirement in all cases. As a result, directors of small companies will need to consider whether further disclosures may be necessary, in addition to those mandated, in order to present a true and fair view.

When preparing true and fair accounts, directors of small companies will wish to look to accounting standards as a source of guidance. We note that in recent years the FRC has obtained several written legal opinions which confirm that compliance with accounting standards is generally necessary in order to give a true and fair view. Consistent with these opinions, UK accounting standards do not have the force of absolute legal requirements but instead provide guidance on what is generally accepted as being necessary to give a true and fair view. We do not see a conflict between the continued provision of such guidance for small companies and the requirements of the Directive.

We understand that BIS has interpreted the restriction on gold-plating in the Directive as extending to accounting standards published by the FRC. Since the FRC is not a public sector body and does not have any role in setting statute, we have questioned this interpretation in our response to BIS's consultation. Also, this interpretation fails to take account of the legal status of UK accounting standards, as explained above.

As further set out in our response to BIS's consultation, we believe it would be far simpler – and permissible under the Directive – to allow accounting standards to set out additional disclosures that are required (where material) to give a true and fair view. This would remove the burden on directors to perform such an assessment themselves and provide them with a clearly defined structure. We urge the FRC to work with BIS to find a pragmatic and helpful solution for small companies in this regard, so that each company does not have to 'reinvent the wheel' for each set of accounts produced. For reference, our full response to BIS's consultation can be accessed at www.ukaccountingplus.co.uk.