29 April 2015

For the attention of Jenny Carter
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Dear Sirs

Consultation on Draft FRS 105: The Financial Reporting Standard applicable to the Micro-entities Regime

We are pleased to respond to your request for comments on draft FRS 105, 'The Financial Reporting Standard applicable to the Micro-entities Regime'. We have responded to the questions posed in the consultation paper in the attached appendix, but also have some overall observations.

We are pleased that the Micro-entities regime has been set out in a separate FRS as in our opinion there are too many differences in measurement principles for it to be usefully combined with FRS 102.

Ideally we would have preferred if there was less cross-referencing to FRS 102, as in our opinion FRS 105 should be a stand alone document for micro-entities to the extent possible. Micro-entities could be encouraged, but not required, to refer to FRS 102 in the event an accounting policy needs to be developed for an item not covered in FRS 105, in much the same way that small entities currently applying the FRSSE look to current UK GAAP. However, we do understand the reasons why the FRC has taken the approach it has in respect of a number of issues thought highly unlikely to apply to micro-entities.

Although we recognise that the FRC's hands are tied, we are still concerned by the 'deeming provision' aspect of the micro-entities regime, i.e. that accounts prepared under FRS 105 will be deemed to give a true and fair view, when given the absence of sufficient explanatory notes they clearly will not. In the event any micro-entity applying the new regime requests an audit, it will be difficult for the auditor to determine what form of opinion they can give. Whilst we expect that the likelihood of any micro-entity applying the regime wanting their accounts to be audited is remote, the possibility nonetheless exists.

We also remain concerned that the reduction in quality of financial reporting under the new regime will lead to the ability of the smallest companies to access credit being compromised, and that the cost savings for micro entities will not be significant.

Overall, however, we believe that the FRC's approach is balanced and proportionate and are particularly pleased to note that micro entities will exempt from the requirement to discount long term loans at a below market rate of interest, e.g. those from related parties.

We hope that our comments are useful to you. If you have any questions on the contents of this letter, then please contact Tessa Park.

Yours faithfully

Kingston Smith LLP

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Appendix 1: Response to consultation questions

1. **Do you agree with the overall approach taken in balancing simplicity with consistency with FRS 102, including use of comparable language and terminology? Do you agree with replacing sections and paragraphs that have been deleted with the term 'not used'?**

Overall we believe that the approach taken strikes a good balance between consistency with FRS 102 and simplicity of approach. However, we would prefer it if the paragraphs replaced with 'not used' were deleted entirely and a similar approach taken with sections of FRS 102 not used in FRS 105. Given that a number of paragraphs which are present in both Standards are completely different in FRS 105 from their equivalent in FRS 102 we do not see any real point in maintaining consistency of numbering. Indeed, using a separate numbering system would reinforce the impression of a one-stop shop accounting standard for micro-entities.

We also believe this approach would make FRS 105 easier to read and therefore more user friendly to a preparer of micro-entity accounts – as drafted, FRS 105 almost forces the reader to consider what might be in the deleted section and to refer to an accounting standard they will most likely not need to consider.

2. **Do you agree that draft FRS 105 accurately reflects the legal requirements and exemptions of the micro-entities regime including its scope, the presentation and format of financial statements, the prohibition of the use of the Alternative Accounting Rules and Fair Value Rules and the disclosure exemptions?**

Overall yes, we do agree that the draft FRS accurately reflects the requirements.

3. **Do you agree with the principles used by the FRC (burden vs benefit, understandability of financial information, frequency of transactions among micro-entities) in determining what simplifications would be appropriate in draft FRS 105 and with the resulting simplifications?**

Yes, we agree that these principles are sensible as are the resulting simplifications.

4. **Do you agree with the further simplifications for the measurement of financial instruments in section 11 *Basic Financial Instruments*? Do you believe any further simplifications are necessary?**

We are very pleased that micro-entities will not be required to discount long term loan balances at a below market rate of interest, e.g. funding provided by an owner manager. As the FRC is aware, this is an issue which is causing widespread concern in practice, and in our view would have been onerous to require micro-entities to apply.

However, we believe that there is scope for the drafting of the relevant paragraphs of the Standard to be clearer – as currently drafted this part of section 11 is confusing when the message is relatively simple (i.e. amortised cost for such loans equals cost and no discounting is required).

5. **Do you agree with the removal of the option to permit capitalisation of development costs and borrowing costs and to require both to be expensed?**

Given that the overall approach of the micro-entities regime is to remove accounting policy options on the grounds of simplicity, we agree that this approach makes sense. It might lead to some issues on transition for any companies that have previously capitalised such expenses if significant amounts are recognised in retained earnings on transition to the new Standard.

6. Do you agree with the removal of the option to account for government grants by the accruals method and to mandate use of the performance method?

We agree that an accounting policy option should be removed on grounds of simplicity and consistency with the overall approach, however we are concerned that the wrong method has been selected and that the accruals method would be more in keeping with the remainder of the recognition and measurement requirements of the Standard.

7. Do you agree with the simplifications via cross-referencing to FRS 102 for certain transactions which are expected to occur infrequently for micro-entities (e.g. intermediate payment arrangements, trade and asset acquisitions)?

As noted in our introductory remarks we would prefer it if FRS 105 were kept as close as possible to a stand alone document. However we do understand why the cross-referencing approach has been taken which has precedent in the cross referencing in FRS 102 of certain issues to full IFRS (e.g. earnings per share, segmental reporting).

In our opinion, where a particular issue is not covered in FRS 105, the cross-referencing could be replaced by a requirement to consider the definitions, recognition and measurement concepts and pervasive principles in section 2 (as is already set out in paragraph 10.5) with the entity being encouraged, but not required, to consider the requirements of FRS 102. As noted in our introductory remarks this would be consistent with the approach currently used in practice for companies adopting the FRSSE.

We do however believe that guidance on intermediate payment arrangements (e.g. EBTs) should be retained in FRS 105 as in our experience a number of micro-entities do enter into such arrangements. Given that micro-entities will not now disclose their accounting policy for such arrangements we believe that clear guidance on how they should account for such arrangements could usefully be included in the Standard.

8. Do you believe that any further simplifications need to 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 simplifications should be made.

No, we believe that the simplifications made are appropriate. However, we are disappointed that the FRC has taken the view that to permit a 'revaluation as deemed cost' transitional exemption for previously revalued property, plant and equipment or investment properties is inconsistent with the legal framework.

It could be quite onerous for some companies, e.g. single property investment property companies, to unwind what may be many years of revaluations and fully restate to historical cost. Not to provide an exemption to micro-entities that is available to small (or indeed larger) entities also appears at odds with the principle of reducing burdens for the smallest entities.

We also believe that it needs to be made clearer that micro-entities are not permitted to account for deferred tax. As currently drafted this section of the Standard (specifically paragraph 29.6) could be read as though micro-entities have the option to account for deferred tax should they wish to do so, which we do not believe is the intention of the Standard.

9. Do you agree with the approach taken in respect of residents management committees, i.e. to include a clear statement of the legal position (that such companies act as principals) be included in the Accounting Council's advice to the FRC? If not, what alternative approach do you propose?

We understand the reasons for not including guidance in section 34 of FRS 105 however we are concerned that including a clear statement only in the Accounting Council's advice to the FRC may mean that it is overlooked.

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 do not have any comments on the Impact Assessment in relation to its application to micro-entities, although as noted in our introductory remarks we are not convinced there will be significant cost savings and remain concerned about the quality of financial reporting for entities preparing their accounts under the micros regime. We have commented on other elements of the Impact Assessment in our separate responses on FREDs 59 and 60.