

# Draft amendments to FRS102 – small entities and other minor amendments

Exposure draft FRED59 issued by the Financial Reporting Council in February 2015

Comments from ACCA

30 April 2015

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Further information about ACCA' s comments on the matters discussed here may be obtained from the following:

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ACCA welcomes the opportunity to provide comments on FRED 59. UK and Ireland-based members of our Global Forum for Corporate Reporting, along with representatives of ACCA' s UK member networks, have considered the questions raised, and their views are reflected in the following comments.

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## GENERAL COMMENTS

We support the withdrawal of the Financial Reporting Standard for Smaller Entities (FRSSE) and its replacement for small entities by accounting based on FRS102 as proposed in FRED59.

We consider, however, that there are significant amendments which should be made to FRED59 to make it more usable and relevant for small entities. Despite the relatively imminent date of application (from 1 January 2016), this is a significant change affecting the financial reporting of millions of entities. FRC should take the time, and there is in our view sufficient time, to revise FRS102 for small entities and try to get it right first time rather than have to revise it with in a short period of time or to impose an unsatisfactory standard.

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## SPECIFIC COMMENTS ON PROPOSED ADAPTATIONS FOR SMALL ENTITIES

### **General approach in Section 1A**

FRED59 proposes that there should be a new Section 1A inserted into FRS102 which would set out all the presentation and disclosure requirements that would apply to small companies. It would note that the sections dealing with the principal statements (Sections 4, 5 6 and 7) would not apply in their entirety to small entities and likewise the note disclosure requirements set out in each of the other sections of FRS102.

We disagree with the approach of Section 1A. It relies on a series of cross references to company law and other sections of FRS102 which makes it very unfriendly to users who either have to know them or

look them up in order to understand what is required of the financial statements of small entities.

Our suggestion is that Section 1A should instead set out the presentations of the various formats for profit and loss account and balance sheet which are available to small companies, in place of Sections 4 to 7. For the notes to the financial statements, each section of FRS102 should set out the disclosure requirements applicable to all companies and then under a separate heading add those applicable to medium and large companies. Alternatively the latter could be asterisked. This structure is much easier to understand than the cross-referenced exemption method in FRED59. It conforms to the generally-favoured 'think small first' approach. Finally it would encourage the greater disclosures for the 'true and fair view' requirement that are currently in paragraphs 1A.12 and 1A.13.

### **Choices need to be highlighted**

Company law offers significant choices to small companies in terms of the formats for the profit and loss account and balance sheet and FRS102 needs to reflect those, but do so more clearly than in FRED59. At present there are a series of cross references in paragraphs 1A.5 to 7 (for the balance sheet) and 1A.9 to 11 (for the profit and loss account). It would be much better if Section 1A set all (rather than just one) of those out in full, including the encouragement (which we very much support) to add more disaggregation if the abridged formats are used.

## **True and fair requirements**

FRED59 explains that though there are fewer specific requirements for disclosure by small entities, there is a general requirement that the financial statements contain all the information needed so that the accounts show a true and fair view. Directors, professional accountants and auditors (if any) of small companies need to exercise judgement, to a greater degree than before, as to whether that obligation has been met. FRS102 needs to provide help and guidance to assist with this. We very much agree with the content in paragraphs 4, 6, 12, 13, and 15 of Section 1A, however this guidance needs to be gathered together in a prominent subsection of its own.

In addition FRC needs to provide a revised supporting legal opinion on the meaning of 'true and fair' which reflects the changes in the law (see below).

## **Retaining information content**

There is significant analysis of items which is currently required by the FRSSE which will be lost to the detriment of the quality of small company accounts and to the disadvantage of users of those accounts. We consider that the FRC should carry out an inventory of such items and then judge what it can or should reinstate.

For example the intention of 1A.7 appears to be mandating a version of the main Directive format providing a broadly equivalent level of

disaggregation, but using the language/headings from IFRS for SMEs. Section 1A should require more disaggregation of inventories and of intangible assets, in the same way as it has for property, plant and equipment.

Furthermore the Directive in Article 9.2 allows member states to require subdivisions of the format items. FRC should take advantage of these to require some analysis of items that were required in the FRSSE but will otherwise be lost. For example analyses of main components of

- Provisions
- Long term contract balances
- Deferred tax
- Pension provisions

### **Recognition and measurement simplification**

FRC should not set in stone a principle that all recognition and measurement requirements for medium and large sized entities need to be applied to small which could be a hostage to fortune in terms of future requirements which may arise via IFRS. Leaving the FRC to consider changes on their merits would seem the better approach.

Further we would like the FRC to reconsider some of the recognition and measurement requirements that will be demanded of small entities and assess really whether they meet the cost-benefit test for them. Those requirements include

- Deferred tax

- Equity-settled share based payments to be included as an expense based on the fair value at the date of issue
- Loans to/from related parties which may carry non-market rates of interest, to be shown at the net present value of the future cash flows
- Identifying intangible assets on a business combination separately from goodwill
- Professional valuations for investment properties

### More detailed comments

Our more detailed comments on the draft Section 1A are as follows:

- The wording of 1A.8(d) is not very clear. It appears to require OCI items to be shown or is it just requiring a balance sheet analysis of reserves?
- In 1A.14 it is not clear whether the requirements of (i) and (k) can be required under the Directive.
- In (l) the examples of items which might be needed to satisfy the requirement to disclose commitments and contingencies are helpful, but they should be more fully described than simply quoting the cross reference to the paragraph number.
- In (t) it does not seem clear what sort of off-balance sheet arrangements should be included here.
- In (v) disclosure will only be required of transactions not under normal market conditions. Firstly that means that related party transactions are now going to be differently defined in comparison to Section 33 of FRS102 and IAS24 which both

require disclosure of all related party transactions whether on normal terms or not. Secondly whether they are on normal terms or not can be a difficult judgement. We consider that this should be realigned by requiring the disclosure of all such transactions. We recognise that small entities could opt to provide disclosures of all related party transactions.

### **Timing**

The new standard will be mandatory for accounting periods beginning 1 January 2016 but is intended to be available for early adoption from a year earlier. We agree with that, especially since the new legal regime for small companies will be available for early adoption in a similar way. That clearly points the way to making the new accounting standard for small entities available as soon as possible. However we believe it is more important that such a major change for so many reporting entities should be right first time rather than rushed out. The first financial statements of small entities that will need the new standard will mostly start to be prepared in the first half of 2017 for publication in the second half. FRC needs to take the time to improve the presentation of FRS102 for small entities and for example to reconsider whether there are recognition and measurement simplifications that can be made for small entities.

### **Other changes needed**

As noted above the concept of the true and fair view has been significantly altered by recent company law changes. For example the micro company regime has included a legal presumption of true and



fair accounts, as we have noted in our response to FRED58, whose implications need to be incorporated. The FRC seem to have concluded in FRED59 that accounting standards cannot specify disclosures that might be needed for a true and fair view above the maximum in the law, but only encourage companies to consider further ones. There is an existing legal opinion on the interpretation of the true and fair view which is a significant underpinning for the status of accounting standards in the UK. The changes and issues that are being implemented need to be clarified and addressed in a new or revised legal opinion.

The application of the recognition and measurement requirements of FRS102 to all individual financial statements of UK companies should prompt a re-consideration and updating of the definition of distributable profits. We believe there would be merit in FRC taking on this role given its significance for accounting and reporting.

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## RESPONSES TO FRC' S SPECIFIC QUESTIONS

We now respond to the specific questions raised in the ED, as follows:

**Q1. Do you agree that the proposed Section 1A adequately reflects the new small companies' regime set out in company law and that the disclosure requirements for small entities are clear?**

No. See our comments on small companies above.

**Q2. 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. Do you agree with this principle?**

No. See our comments on small companies above.

**Q3. Do you agree that the transitional provisions in FRS102 are sufficient for small entities?**

Yes.

**Q4. Do you agree with the other amendments proposed to FRS102 for compliance with company law?**

Yes.

**Q5. This FRED is accompanied by a consultation stage impact assessment. Do you have any comments on the costs and benefits discussed in that assessment?**

No.