Financial Reporting Council

September 2014

Consultation Document

Accounting standards for small entities

Implementation of the EU Accounting Directive

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Contents

Introduction

1. FRS 100 *Application of Financial Reporting Requirements* sets out the financial reporting framework that applies in the UK and Republic of Ireland. The accounting standards that may be applied by an entity vary depending upon a number of factors including its size, whether it is part of a group and whether its shares are listed on a regulated market. Following the implementation of the new EU Accounting Directive[1] in the UK and Republic of Ireland this will continue to be the case, but accounting standards will be revised to reflect new legislative requirements or to take advantage of new options available in legislation.

2. The Department for Business, Innovation and Skills (BIS) is consulting on the implementation of the Accounting Directive in the UK in its consultation *UK Implementation of the EU Accounting Directive – Chapters 1-9: Annual financial statements, consolidated financial statements, related reports of certain types of undertakings and general requirements for audit*.[2] The Irish Department of Jobs, Enterprise and Innovation has already consulted in its *Consultation on the transposition of the EU Accounting Directive 2013/34/EU*[3] which closed on 31 March 2014. In response to both consultations, the FRC is issuing this Consultation Document on the development of accounting standards.

3. The most significant change arising from the new Accounting Directive relates to the small companies regime, where accounting standards may not specify disclosure requirements in addition to the limited number of disclosures set out in the new Accounting Directive, even though entities must still provide any additional disclosures necessary to give a true and fair view. Although the FRC had always intended to consult on the recognition and measurement of items in the financial statements of small entities following the introduction of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, it would not have proposed such a reduction in mandatory disclosures if it were not required to. The FRC is concerned that a greater burden will be placed on the directors of companies (and those charged with governance in relation to other entities) to determine and provide those specific additional disclosures that should be made in order to provide a true and fair view.

4. Taking into account the proposed UK[4] legislative changes, broadly we propose that the following framework should apply:

   (a) Micro-entities will be able to apply the *Financial Reporting Standard for Micro-Entities* (FRSME). See Section 2.

   (b) Small entities will apply FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, but a new section will be inserted setting out the presentation and disclosure requirements applicable to small entities, which will be based on the new legal provisions. Otherwise the scope of FRS 102 will remain the same. See Section 3.

   (c) Entities that are required by the IAS Regulation or other legislation or regulation to prepare their financial statements in accordance with EU-adopted IFRS will continue to do so.

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1 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013.

2 www.gov.uk/bis

3 http://www.djei.ie/commerce/companylawlegislation/Consultation_Directive_2013-34-EU.pdf

4 The Irish Department of Jobs, Enterprise and Innovation (DJEI) has already consulted in its Consultation on the transposition of the EU Accounting Directive 2013/34/EU which closed on 31 March 2014. However, the Irish Government has not issued a formal proposal as to how the new Accounting Directive might be transposed into national legislation nor as to how the options available to Member States might be applied.

(d) A qualifying entity will continue to have the option to prepare its financial statements in accordance with FRS 101 *Reduced Disclosure Framework*.

(e) An entity will continue to have the option to apply a more comprehensive accounting standard. For example, a micro-entity will be able to choose between the FRSME, the small companies regime within FRS 102, FRS 102 in full or EU-adopted IFRS.

5. After considering the feedback to this Consultation Document, the FRC will develop these proposals further and issue Exposure Drafts to invite comments on the detailed amendments being proposed. The FRC expects the new and amended accounting standards to be effective from the same date as the changes in legislation are effective, which is expected to be accounting periods beginning on or after 1 January 2016.

6. This consultation relates to the full financial statements that must be prepared by an entity. For some entities legislation may provide for more limited, or abbreviated, information to be placed on the public record. This is not a matter for accounting standards, and is not addressed in this consultation.

Invitation to comment

1. The FRC is requesting comments on this Consultation Document by 30 November 2014. The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the Consultation Document. In particular, comments are sought in relation to the questions below.

Micro-entities

Micro-entities are described in paragraph 2.1. The turnover limit is £632,000.

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?

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?

Small entities

Small entities are described in paragraphs 3.1 and 3.2. The new turnover limit is proposed to be £10.2million.

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?

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?

Residential management companies

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 sub-section 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?

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?

FRS 101

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?

2. Information on how to submit comments and the FRC's policy in relation to responses is set out on page 24.

1 Financial reporting framework

1.1 FRS 100 *Application of Financial Reporting Requirements* sets out the financial reporting framework that applies in the UK and Republic of Ireland. The accounting standards that may be applied by an entity vary depending upon a number of factors including its size, whether it is part of a group and whether its shares are listed on a regulated market. Following the implementation of the new EU Accounting Directive[5] in the UK and Republic of Ireland this will continue to be the case, but accounting standards will be revised to reflect new legislative requirements, and, where considered appropriate, may take advantage of new options available in legislation.

1.2 BIS is consulting on the implementation of the Accounting Directive in the UK in its consultation *UK Implementation of the EU Accounting Directive – Chapters 1-9: Annual financial statements, consolidated financial statements, related reports of certain types of undertakings and general requirements for audit*.[6] The Irish Department of Jobs, Enterprise and Innovation has already consulted in its Consultation on the transposition of the EU Accounting Directive 2013/34/EU[7] which closed on 31 March 2014.

1.3 The subsequent development and amendment of accounting standards for the UK and Republic of Ireland, by the FRC[8], will depend upon the changes made to legislation. Taking into account the proposed UK legislative changes broadly we propose that the following framework should apply:

(a) Micro-entities will be able to apply the *Financial Reporting Standard for Micro-Entities* (FRSME). See Section 2.

(b) Small entities will apply FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, but a new section will be inserted setting out the presentation and disclosure requirements applicable to small entities, which will be based on the new legal provisions. Otherwise the scope of FRS 102 will remain the same. See Section 3.

(c) Entities that are required by the IAS Regulation or other legislation or regulation to prepare their financial statements in accordance with EU-adopted IFRS will continue to do so.

(d) A qualifying entity[9] will continue to have the option to prepare its financial statements in accordance with FRS 101 *Reduced Disclosure Framework*.

(e) An entity will continue to have the option to apply a more comprehensive accounting standard. For example, a micro-entity will be able to choose between the FRSME, the small companies regime within FRS 102, FRS 102 in full or EU-adopted IFRS.

As a consequence, the Financial Reporting Standard for Smaller Entities (FRSSE) will be withdrawn.

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5 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013.

6 www.gov.uk/bis

7 http://www.djei.ie/commerce/companylawlegislation/Consultation_Directive_2013-34-EU.pdf (the DJEI Consultation document).

8 As accounting standard setter in both jurisdictions: the FRC is a prescribed body for issuing accounting standards in the UK, as set out in the *Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012* (SI 2012/1741); while *The Foreword to Accounting Standards* sets out the application of accounting standards in the Republic of Ireland.

9 As defined in FRS 101 *Reduced Disclosure Framework*.

1.4 This change in the overall framework is illustrated below. However, entities may be able to apply other accounting standards for which they are eligible, for example FRS 102 will be available to all the following entities.

	Micro-entity	**Small**	**Larger**	**Qualifying group entity (listed groups)**
Current framework (from 1 January 2015)				
Turnover limit	£632,000[10]	£6.5million[11]	N/A	N/A
Accounting standard	FRSSE - special rules	FRSSE	FRS 102	FRS 101
Based on	Old UK and Irish GAAP	Old UK and Irish GAAP		IFRS
Proposed framework (from 1 January 2016)				
Turnover limit	£632,000[12]	£10.2million[13]	N/A	N/A
Accounting standard	FRSME - simplified FRS 102	FRS 102 - limited mandatory disclosures	FRS 102	FRS 101

1.5 Although there will be limited change for entities currently within the scope of FRS 101 or FRS 102, some amendments will be necessary to reflect changes in legislation and other changes may be possible as a result of expected new provisions of company law. However, we are not undertaking a general review of the requirements of FRS 102 at this time, nor anticipating making changes to FRS 102 other than those derived from changes in company law. See Sections 4 and 5.

Objective

1.6 In further developing and amending accounting standards the FRC continues to apply its overriding objective:

> To enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

1.7 Financial statements that provide a true and fair view are central to meeting this objective. This requirement continues to be fundamental in the new Accounting Directive, which further requires that where compliance with its requirements would not be sufficient to give a true and fair view any necessary additional information should be provided. However, the new Accounting Directive and its implementation in the UK and the Republic of Ireland will place limits on the requirements that the FRC may include in accounting standards, for example the new Accounting Directive:

(a) prohibits remeasurement and the use of fair value by eligible entities choosing to apply the micro-entities regime[14]; and

(b) restricts the disclosures that can be required by micro-entities and small entities.

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[10] The micro-entities regime is not available in the Republic of Ireland at present, but has been consulted on in the DJEI Consultation document.

[11] In the Republic of Ireland the turnover limit is €8.8million.

[12] In the Republic of Ireland the turnover limit will be €700,000 if the option is exercised.

[13] The Republic of Ireland has not yet proposed the equivalent turnover limit, however the new Accounting Directive limit is Turnover at or above €8million and below €12milion.

[14] At present the micro-entities regime is only available in the UK. The Irish Government has not, to date, made legislation with regard to micro-entities.

1.8 The FRC supports appropriate deregulation and clear and concise reporting by entities, but is concerned that some of the changes in legislation could impair the usefulness of the resulting financial information and/or place an even greater onus on the directors of small companies in their assessment of whether the resulting financial statements provide a true and fair view, and if not to take appropriate action. Although the FRC will make the changes to accounting standards that are required by the changes in legislation, not all of these changes are consistent with the FRC's vision for financial reporting (see paragraphs 2.7 and 3.10).

Financial Reporting Standard for Smaller Entities (FRSSE)

1.9 The FRC also continues to believe that to achieve its objective it should continue to provide succinct financial reporting 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. As a result, one of the key changes that is proposed is the withdrawal of the *Financial Reporting Standard for Smaller Entities* (FRSSE) to be replaced with:

(a) the FRSME for entities choosing to apply the micro-entities regime; and

(b) a small companies regime within FRS 102.

The FRSME will be based on the recognition and measurement requirements of FRS 102, and therefore small companies, whether applying the FRSME or the small companies regime within FRS 102, will be applying accounting treatments that are consistent with, or a simplified version of, those applied by larger companies (to the extent permitted by legislation). This will reduce the accounting changes that will be necessary as entities grow.

Development from Consultation Document to new/amended accounting standards

1.10 After considering the responses to this Consultation Document the FRC will develop these proposals further and issue Exposure Drafts to invite comments on the detailed amendments being proposed. It is likely that the final standards will be issued in the summer of 2015. The FRC expects the new and amended accounting standards to be effective from the same date as the changes in legislation are effective, which is expected to be for accounting periods beginning on or after 1 January 2016.

1.11 The FRC recognises that this means that there is likely to be fewer than six months between the standards being issued and their effective date, and that for many entities the start of the comparative period (ie transition date) will already have passed. However, the changes to the accounting standards are being driven by changes in legislation, and the accounting standards cannot be finalised until after the legislation has been made.

1.12 Entities may need to give some thought to the availability of data as at the start of the comparative period, particularly where accounting policies may change. However, we will also give careful consideration to the need for transitional provisions. In particular, for small entities preparing their first financial statements in accordance with the small companies regime within FRS 102, we intend to give consideration to the availability of historical data at the time that an entity is preparing its financial statements.

2 Micro-entities

2.1 Micro-entities are the smallest companies. The definition of a micro-entity is contained in sections 384A and 384B of the Companies Act 2006 (the Act). The qualifying conditions are met by a company in a year in which it does not exceed two or more of the following criteria[15]:

Turnover	£632,000
Balance sheet total	£316,000
Number of employees	10

2.2 A micro-entity may choose to apply the micro-entities regime, or to apply another accounting standard for which it is eligible.

2.3 The micro-entities regime was brought into UK legislation in November 2013; no legislative proposals have as yet been issued in the Republic of Ireland, although it has been consulted on as part of the DJEI Consultation document. The *Financial Reporting Standard for Smaller Entities* (FRSSE) was amended to reflect the new UK micro-entities regime in April 2014. The BIS consultation indicates a proposed disclosure change may be made in relation to micro-entities. Further, as noted when the *Amendments to the FRSSE – Micro-entities* was issued, the FRC has been considering how best to present the requirements for micro-entities in the most user-friendly way for the longer term.

2.4 The FRC now proposes to issue a new accounting standard for micro-entities, the *Financial Reporting Standard for Micro-entities* (FRSME). This will be developed from the recognition and measurement requirements of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, thereby improving consistency across the financial reporting framework, but adapted to reflect the micro-entities regime as set out in legislation and simplified further where appropriate for micro-entities.

2.5 The key features of the micro-entities regime are as follows:

(a) The regime only applies to micro-entities that are companies and cannot be applied by public benefit entities or financial institutions.

(b) The regime does not apply to the financial statements (consolidated or individual) of parent companies that choose to prepare consolidated accounts, or the individual financial statements of subsidiaries that are included in consolidated accounts. Therefore, the regime only applies to the preparation of individual financial statements.

(c) The only financial statements required to be prepared by micro-entities are a balance sheet (choice of 2 formats) and a profit and loss account (only 1 format). No other statements (eg a cash flow statement) are required.

(d) Micro-entities are not permitted to use the Alternative Accounting Rules or Fair Value Rules set out in company law and therefore are not permitted to revalue or measure assets or liabilities at fair value.

(e) Company law specifies the disclosure of information in relation to guarantees and other financial commitments and advances, credit or guarantees to/on behalf of directors to be included in the financial statements of a micro-entity and neither the law nor accounting standards may add further mandatory disclosures.

[15] In the Republic of Ireland the equivalent limits are Turnover €700,000, Balance sheet total €350,000 and Number of employees 10. The DJEI is still considering the responses to the DJEI Consultation document and the limits in Article 3(1) of the Directive will apply if the option is exercised.

(f) Financial statements prepared under the regulations are presumed to give a true and fair view.

2.6 The FRC proposes to simplify the accounting framework for micro-entities in the new accounting standard for micro-entities, the FRSME, as follows:

(a) Presentation and disclosure requirements as set out in legislation (summarised above and currently set out in paragraphs 2.40 to 2.42 of the FRSSE).

(b) Recognition and measurement requirements based on FRS 102 except for:

(i) simplification of the requirements for financial instruments, which will be solely based on historical cost or amortised cost;

(ii) no requirement to account for deferred taxation;

(iii) no requirement to account for equity-settled share-based payments prior to the issue of the shares;

(iv) a simplification to accounting for post-employment benefits, that will permit defined benefit plans to be accounted for as defined contribution plans (including recognition of a liability for contributions payable arising from an agreement to fund a deficit in relation to past service because the micro-entity will no longer be recognising the net asset or liability arising from the defined benefit plan);

(v) no option to capitalise borrowing costs; and

(vi) deletion of sections that are unlikely to be applicable to micro-entities, such as Section 19 *Business Combinations and Goodwill* (with a cross-reference to FRS 102 if a micro-entity has undertaken a trade and assets acquisition), Section 31 *Hyperinflation* and most of Section 34 *Specialised Activities* (the sub-Section *Agriculture* will be retained).

2.7 Some micro-entities may have derivatives like interest rate swaps and forward foreign currency contracts. The FRC is not able to require either recognition of derivative financial instruments at fair value or disclosure of the existence and nature of such instruments, as this is prohibited by law. However, the FRC proposes that the FRSME will clarify that when a derivative financial instrument becomes onerous the resulting obligation shall be recognised at its present value.

2.8 Subject to the constraints of the legal framework the FRC believes that the proposed FRSME should meet the needs of those micro-entities choosing to apply the micro-entities regime and the users of their financial statements. Accounting for individual transactions will be broadly consistent with larger entities, which should assist users in understanding the financial statements and will mean that as entities grow there will be limited changes in accounting. It will also mean that advisers can apply broadly consistent requirements across entities of all sizes.

2.9 It is proposed that the FRSME will be available to any entity permitted by law to apply the micro-entities regime and in the UK it will be available from the date of its issue given that the relevant legislation has already been made[16].

[16] In the Republic of Ireland, the FRSME will be available in line with the effective date of the relevant legislation, if enacted.

3 Small entities

3.1 Small entities are those companies that meet the definition of a small company as set out in company law and any other entities that would meet those criteria if they were a company.

3.2 BIS is consulting on changing the small company thresholds. Broadly[17], it is proposed that the qualifying conditions are met by a company in a year in which it does not exceed two or more of the following criteria[18]:

Turnover[19]	£10.2million
Balance sheet total	£5.1million
Number of employees	50

3.3 In addition to the size criteria, to be able to apply the small companies regime a company must not be ineligible. The eligibility criteria are set out in company law, and mean that a number of small entities, including financial institutions, are ineligible for the small companies regime as a result of the nature of their business.

3.4 The new Accounting Directive substantially changes the small companies regime. This is described in more detail in the BIS consultation document[20]. A small company may choose to apply the small companies regime, or to apply another accounting standard for which it is eligible.

3.5 The FRC notes that the changes in the small companies regime only directly affect companies. However, as with the current *Financial Reporting Standard for Smaller Entities* (FRSSE) the FRC proposes that accounting standards for small entities should continue to apply to both companies and other entities meeting the qualifying criteria. After taking into account those entities that might be ineligible to apply the FRSSE as a result of the nature of their business, the FRC considers that the entities that are not companies but apply the FRSSE are most likely to be limited liability partnerships (LLPs) and charities. In both cases a SORP may provide further guidance.

Disclosures

3.6 A key feature of the new small companies regime set out in the new Accounting Directive is that it specifies the mandatory disclosures to be included in a small company's financial statements. The FRSSE contains requirements for disclosure in excess of those that will be permitted by the new Accounting Directive and new UK and Irish company law. Therefore the FRSSE cannot continue in its current form once the new legal requirements become effective.

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[17] Company law will set out the detailed requirements that must be met for a company to qualify for the small companies regime. Some entities that meet the size criteria will not be eligible for the small companies regime as a result of other factors, including the nature of their business (including credit institutions and insurance undertakings).

[18] The Republic of Ireland has not yet decided on the equivalent limits, however the new Accounting Directive limits are Turnover at or above €8million and not exceeding €12milion, Balance sheet total at or above €4million and not exceeding €6million and Number of employees 50. DJEI is still considering the responses to the DJEI Consultation document on Member State options.

[19] BIS is consulting on whether other sources of income should be included with turnover for the purposes of calculating the thresholds.

[20] Questions 4 to 7 of the DJEI Consultation document refer. DJEI is still considering the responses to the DJEI Consultation document on Member State options.

3.7 The mandatory disclosure requirements for small companies set out in the new Accounting Directive are summarised below:

(a) the accounting policies adopted;

(b) where fixed assets are measured at revalued amounts, a table showing the movements in the revaluation reserve and the carrying amount in the balance sheet had the assets not been revalued;

(c) information about financial instruments and/or other assets measured at fair value including the significant assumptions underlying the valuation models and techniques used, the changes in fair value included in profit or loss and reserves, the extent and nature of derivative financial instruments, and a table showing movements in the fair value reserve during the financial year;

(d) information about financial commitments, guarantees or contingencies that are not included in the balance sheet;

(e) information about advances and credits granted to administrative, managerial and supervisory bodies;

(f) the amount and nature of individual items of income or expenditure which are of exceptional size or incidence; and

(g) the average number of employees during the financial year.

3.8 In addition, Member States are permitted to require disclosure of the following five items:

(a) the fixed asset movement table;

(b) information about off-balance sheet arrangements;

(c) information about material post balance sheet events;

(d) information about related party transactions; and

(e) the name and registered office of the undertaking drawing up the lowest level of consolidated financial statements in which the entity is included.

3.9 As set out in the BIS consultation document, the Government proposes that these disclosures are required in the UK[21]. The FRC has reviewed these five disclosures and agrees that, where they are applicable to a reporting entity, they are relevant to providing a true and fair view of the entity's financial performance and/or financial position and therefore proposes that accounting standards will require small entities to provide these disclosures. As the FRC believes that these disclosures are relevant to providing a true and fair view, the FRC does not consider that this will increase the financial reporting burden on small entities, and these will not be new requirements for small entities.

3.10 Neither the law nor accounting standards may add to the disclosures set out above; however, the financial statements of a small company must still give a true and fair view of the financial performance and financial position of the entity. The directors of a company need to consider whether additional disclosures are necessary to give a true and fair view. In comparison to current requirements, this places an even greater onus on the directors of small companies to stand back and consider whether financial statements give a true and fair view and, if not, to provide additional disclosures. In providing any additional disclosures entities may find the disclosure requirements of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, that relate to larger entities, to be helpful guidance. This process for determining the appropriate level of disclosure individually could increase the cost of preparing financial statements, where

[21] Questions 44 to 48 of the DJEI Consultation document refer. DJEI is still considering the responses to the DJEI Consultation document on Member State options.

previously in most cases compliance with the FRSSE should have resulted in sufficient disclosure being provided for the financial statements to give a true and fair view.

3.11 The FRC considered whether to require additional disclosure of small entities that are not companies (where the legal restriction on mandating additional disclosure does not apply), but was concerned that this may make the small entities regime within FRS 102 confusing, with different requirements for different types of entity. Therefore, as noted in paragraph 3.5 the FRC proposes that the accounting standards for small companies should apply equally to other small entities.

3.12 In addition, accounting standards will no longer be permitted to require the preparation of additional financial statements over and above the requirement to prepare a balance sheet and profit and loss account. As a result, small companies will no longer be required to provide a statement of total recognised gains and losses, which is currently required by the FRSSE.

3.13 In conclusion, the FRC proposes to revise the accounting standards applicable to small entities for consistency with the new legal presentation and disclosure requirements. This will have the effect of:

(a) maintaining consistency of accounting standards with company law;

(b) reducing mandatory disclosure requirements for companies and other similarly-sized entities; and

(c) retaining the requirement to provide additional disclosures where necessary to provide a true and fair view.

Other areas for improvements in small entity financial reporting

Consistency with FRS 102

3.14 When the FRC was consulting on the development of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* it proposed retaining the FRSSE for a period and consulting again on the options for financial reporting by small entities in light of potential changes to the EU Accounting Directive[22]. Some respondents requested certainty over the FRSSE's future and there were also calls for small companies to apply FRS 102 with reduced disclosure, which would streamline the overall financial reporting framework[23].

3.15 The FRC proposes that small companies should be brought within the scope of FRS 102, consistent with feedback previously received from stakeholders, and the FRSSE should be withdrawn. A new section (Section 1A *Small Entities*) will be added to FRS 102 setting out the framework and presentation and disclosure requirements for small entities.

3.16 Whilst we propose that small companies will apply the recognition and measurement requirements of FRS 102, the standard will only mandate the limited disclosures as set out in company law, based on the new Accounting Directive; therefore small companies:

(a) will not be required to provide any additional primary financial statements such as a cash flow statement, a statement of total comprehensive income or a statement of changes in equity; and

(b) will continue to be exempt from the requirement to prepare consolidated financial statements.

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[22] See FRED 43 *Application of Financial Reporting Standards* and FRED 46 *Application of Financial Reporting Requirements*.

[23] See Feedback Statement on FREDs 46 to 48 issued in March 2013.

3.17 The FRC believes that following the recognition and measurement requirements of FRS 102 will improve financial reporting by small entities by, for example, requiring the recognition of various financial instruments that the FRSSE does not currently require, such as derivatives like interest rate swaps and forward foreign currency contracts. Although this is a change in accounting, not all small entities will have such financial instruments.

3.18 It will also reinstate the consistency in accounting policies between those entities that are small and those that are larger. The FRSSE was originally developed from the accounting standards that were previously applied by larger entities but will be withdrawn when new UK and Irish GAAP becomes effective on 1 January 2015. One key principle that has underpinned the FRSSE's development and revisions over the years is that there should be few, if any, differences in recognition and measurement requirements when compared with the accounting standards applied by larger entities. Bringing smaller entities within the scope of FRS 102 will re-establish this principle. The FRC has considered whether there might be a case for recognition and measurement differences between the small companies regime within FRS 102 and FRS 102 more generally; it has concluded to date that there is not. It considers that the recognition and measurement requirements of FRS 102 are suitable for small entities and that there would be disadvantages from introducing a further variation of the framework (having already proposed a new accounting standard for micro-entities).

3.19 All entities will be preparing financial statements that are derived from a common framework. This will make it easier for users of financial statements to understand the framework and principles that have been applied by an entity, and similarly make it easier for those preparing, advising on and auditing financial statements to keep abreast of requirements and apply them consistently. It will also minimise the changes in accounting as entities grow.

3.20 When the FRSSE was first developed in 1997 the accounting standards applied by larger entities ran to approximately 1,000 pages, and the FRSSE was a significant simplification. Over time, the accounting standards applied by larger entities grew to approximately 3,000 pages and the FRSSE was maintained, and updated, as a simplification for smaller entities. However, FRS 102 has been issued with approximately 300 pages, making it more accessible, and the case for a further simplified version for small entities appears weaker; this is in contrast with the regime for micro-entities where the legal prohibitions on remeasurement and fair value accounting create recognition and measurement differences that justify a separate accounting standard.

3.21 In addition, since 1997 the size thresholds for small companies have increased considerably resulting in larger, more complex entities being eligible to apply the small companies regime.

3.22 Paragraph 3.17 notes that there will be changes in financial reporting by small entities in relation to financial instruments. Key elements of these changes will include:

(a) recognising derivatives, such as interest rate swaps and foreign currency forward contracts, and measuring them at fair value;

(b) financial instruments at non-market rates of interest may be measured differently from in the past;

(c) some more complex financial instruments may be measured at fair value; and

(d) transactions in foreign currencies may no longer be recognised at a contract rate, although hedge accounting may be applied which could result in a similar outcome.

3.23 In addition to changes in the financial reporting of financial instruments, there will be other changes for small companies transitioning from the FRSSE to FRS 102, as there will be for all entities applying FRS 102 for the first time. The extent of change will depend on the transactions undertaken by each entity.

3.24 Some of the differences between the recognition and measurement requirements of the FRSSE and FRS 102 include the following:

(a) changes in the fair value of investment property being recognised in profit or loss rather than through the statement of total recognised gains and losses;

(b) recognition of deferred tax on revaluations and in business combinations;

(c) recognition of holiday pay accruals; and

(d) recognition of equity-settled share-based payment transactions when the goods or services are received.

3.25 However, few changes are expected in relation to revenue recognition, which is often a key area for small entities.

Residential management companies (RMCs)

3.26 The FRC has twice consulted on proposals designed to increase consistency in the accounting by residential management companies, most recently in FRED 50 *Draft FRC Abstract 1 – Residential Management Companies' Financial Statements*. The FRC has considered the feedback received.

3.27 The FRC proposes that a new sub-section is added to Section 34 *Specialised Activities* of FRS 102 to address the principles of accounting by residential management companies (RMCs), to be developed from the proposals in FRED 50. However, unlike FRED 50, this sub-section is not expected to include any new disclosure requirements as most RMCs will be small entities or micro-entities for which company law limits the mandating of disclosures.

Impact of an increase in the small company thresholds

3.28 As noted in paragraph 3.2, BIS is consulting on increasing the small company thresholds[24]. This will have the effect of bringing more entities into the small companies regime for accounting periods beginning on or after 1 January 2016; previously they were medium-sized. These entities will have transitioned to FRS 102 for accounting periods beginning on or after 1 January 2015, meaning there will be two consecutive years of change. However, as the FRC is proposing a small companies regime within FRS 102, for the second of these years the impact of the availability of the small companies regime will include the possibility of reduced disclosure. Therefore the FRC does not believe that the second change will be burdensome and does not consider that any transitional arrangements are necessary for entities that will become eligible for the small companies regime as a result of the increase in the small company thresholds.

Effective date

3.29 It is proposed that the small companies regime within FRS 102 will be available for accounting periods beginning on or after 1 January 2016, which is consistent with the proposed effective date for the implementation of the new Accounting Directive. As a result, early application will not be permitted, unless it is permitted in company law.

[24] In the Republic of Ireland, DJEI has consulted on the same matter.

4 Other amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

4.1 In addition to proposing amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* to bring small entities within its scope, there will be a small number of other amendments that are likely to be necessary in order to maintain consistency between FRS 102 and UK and Irish company law.

4.2 The FRC proposes to amend FRS 102 as necessary to ensure consistency with changes in the law arising from the implementation of the new Accounting Directive. At this time the FRC does not propose to undertake a more general review of the requirements of FRS 102; such a review will be carried out as part of the first three-yearly review[25].

4.3 The areas where amendments to FRS 102 may be required as a result to changes in company law are:

(a) updating any specific references to legal requirements that will now be out of date, for example in relation to the formats of the profit and loss account and the balance sheet, and in relation to the requirements to prepare consolidated financial statements;

(b) removal of references to ordinary and extraordinary items for most entities[26] (paragraphs 5.10 and 5.10A of FRS 102);

(c) amending the maximum useful economic life of goodwill and intangible assets, in situations where an entity is not able to estimate the useful economic life, to 10 years (paragraph 18.20 and paragraph 19.23(a) of FRS 102), if this is introduced into company law (see BIS consultation document[27]);

(d) amending paragraph 27.28 of FRS 102 to prohibit a reversal of an impairment loss for goodwill; and

(e) any other areas, subsequently identified or arising as a result of consultation, where changes to company law would result in a change being necessary to FRS 102.

4.4 As discussed in the BIS consultation document[28], the implementation of the new Accounting Directive provides an opportunity to consider whether alternative formats for the profit and loss account and balance sheet should be permitted by law. If this flexibility is brought into UK and Irish company law, the FRC will consider whether any amendments should be proposed to FRS 102, which already contains the current level of flexibility permitted by company law.

4.5 As discussed in the BIS consultation document[29], the implementation of the new Accounting Directive provides an opportunity to consider whether greater flexibility should be permitted in accounting for participating interests in Companies Act individual accounts. If this flexibility is brought into UK and Irish company law, the FRC will consider whether any amendments should be proposed to FRS 102, which currently contains all the accounting policy options available in company law for accounting for participating interests in Companies Act individual accounts.

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[25] The FRC has previously announced that it will carry out the first three-yearly review in 2016/2017, with a view to the revised FRS 102 being effective from 1 January 2018.

[26] Other EU Directives may continue to contain references to ordinary and extraordinary items, for certain types of business only.

[27] Question 37 of the DJEI Consultation document refers. DJEI is still considering the responses to the DJEI Consultation document on Member State options.

[28] Question 40 of the DJEI Consultation document refers. DJEI is still considering the responses to the DJEI Consultation document on Member State options.

[29] Questions 30 and 31 of the DJEI Consultation document refer. DJEI is still considering the responses to the DJEI Consultation document on Member State options.

4.6 Company law requires certain disclosures to be made in an entity's financial statements. At present not all of these disclosures are repeated in FRS 102, and entities must ensure they comply with any relevant legal requirements in addition to compliance with FRS 102. The FRC has considered whether to include additional company law disclosures in FRS 102, for entities that are not small, and has decided that this is not necessary.

5 Amendments to FRS 101 *Reduced Disclosure Framework*

5.1 Companies that apply FRS 101 *Reduced Disclosure Framework* are preparing 'Companies Act accounts' rather than 'IAS accounts'[30] as set out in section 395 of the Companies Act 2006 (the Act)[31]. Therefore changes in company law as a result of the new Accounting Directive could also have an impact on entities applying FRS 101.

5.2 To date, the only amendments to FRS 101 that will be required relate to:

(a) extraordinary items, for which the FRC would propose to delete paragraph AG1(j) of FRS 101; and

(b) prohibiting a reversal of an impairment loss for goodwill, for which the FRC would propose to delete paragraph AG1(s) of FRS 101.

5.3 However, as discussed in the BIS consultation document[32], the implementation of the new Accounting Directive provides an opportunity to consider whether alternative formats for the profit and loss account and balance sheet should be permitted by law. If this flexibility is brought into UK and Irish company law, the FRC will consider whether entities applying FRS 101 will be able to apply the presentation requirements of IAS 1 *Presentation of Financial Statements* and still comply with company law.

5.4 If this is the case the FRC would propose amendments to the Application Guidance in FRS 101, to delete paragraphs AG1(h) and AG1(i) of FRS 101. As the flexibility in the new Accounting Directive depends upon information being presented that is equivalent to that provided if the formats set out in the new Accounting Directive were applied, consideration may need to be given to whether any additional disclosures might be necessary in order to achieve this equivalence.

5.5 Stakeholders have told the FRC that being able to apply the presentation requirements of IAS 1 in financial statements that are prepared in accordance with FRS 101 would reduce the costs of preparing financial statements within groups.

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[30] These are described as 'IFRS accounts' in the context of the Republic of Ireland.
[31] Section 148 of the Companies Act 1963 (as amended) in the Republic of Ireland.
[32] Question 40 of the DJEI Consultation document refers. DJEI is still considering the responses to the DJEI Consultation document on Member State options.

Consultation Stage Impact Assessment

1. As published in its Regulatory Strategy, the Financial Reporting Council (FRC) is committed to a proportionate approach to the use of its powers, making effective use of impact assessments and having regard to the impact of regulation on small enterprises.

2. The overriding objective is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

3. This consultation proposes:

   (a) making amendments to accounting standards as a direct response to changes in legislation that are expected as part of the implementation of the new Accounting Directive;

   (b) to simultaneously improve financial reporting by small entities and micro-entities by withdrawing the *Financial Reporting Standard for Smaller Entities* (FRSSE) and replacing it with the *Financial Reporting Standard for Micro-entities* (FRSME) and a small companies regime within FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

4. Consistently with the FRC's regulatory approach, this *Consultation Stage Impact Assessment* focuses on those aspects of the proposals that augment or diverge from the new Accounting Directive.

Amendments to accounting standards that are required for consistency with company law

5. The Department for Business, Innovation and Skills (BIS) has prepared a Consultation Stage Impact Assessment for the changes in legislation and hence no further impact assessment has been prepared by the FRC.

Introduction of the Financial Reporting Standard for Micro-entities (FRSME)

6. In April 2014 the FRC issued amendments to the FRSSE to incorporate the new UK micro-entities regime, which includes reduced presentation and disclosure requirements for the financial statements and simplifies the measurement options available to micro-entities choosing to apply the regime. With the FRSME the FRC proposes to further simplify the accounting requirements for micro-entities choosing to apply the micro-entities regime by, for example, removing the need to account for deferred tax and simplifying the accounting for defined benefit pension plans.

7. The FRC believes that the proposal for a FRSME:

   (a) meets its overriding objective for micro-entities choosing to apply the micro-entities regime, bearing in mind the limited disclosures that are required by law in order for the financial statements to be presumed to give a true and fair view; and

   (b) generates opportunities for cost savings in the preparation of the financial statements.

   Therefore the FRC believes the proposal for a FRSME is a cost-effective solution for financial reporting in the UK and Republic of Ireland.

Introduction of a small companies regime within FRS 102

8. Given the changes to the small companies regime that will be introduced as part of the implementation of the new Accounting Directive, the FRC does not consider 'do nothing' a viable option; the FRSSE contains various presentation and disclosure requirements that may not be mandated in the future.

9. The FRC considered the following two possible options:
   (a) Option A – incorporate the new small companies regime within FRS 102, reinstating consistency in accounting policies between those entities that are small and those that are larger;
   (b) Option B – amend the presentation and disclosure requirements of the FRSSE to remove any requirements that will no longer be compatible with company law.

Option A – small companies regime within FRS 102

10. When it issued FRS 102, the FRC did not intend to retain, for any significant period, accounting standards for small companies that were not consistent with FRS 102. The FRC had intended to update financial reporting for small entities when the new Accounting Directive was implemented. The advantages of including a small companies regime within FRS 102 are:
    (a) all entities will be applying accounting standards that are based on the same framework, but with some simplifications available for smaller entities; this will:
        (i) increase consistency and comparability in financial reporting between entities; and
        (ii) reduce education and training costs; and
    (b) the improvements in financial reporting that FRS 102 introduced, for example in relation to financial instruments, will apply to all entities increasing transparency for users around the risks associated with financial instruments.

11. The FRC issued an Impact Assessment[33] with FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, which discussed the costs and benefits of its introduction more fully.

12. The disadvantage of including a small companies regime within FRS 102 is that there will be costs associated with the changes in accounting. However, the FRC believes that the improvements in financial reporting and the longer term benefits of a consistent framework outweigh the costs of transition, and therefore the FRC is proposing incorporating a small companies regime within FRS 102.

Option B – amend the FRSSE

13. The advantage of amending the FRSSE would be that there were no changes in accounting by small entities other than any reduction in disclosures permitted by the changes in company law.

14. The disadvantages of amending the FRSSE would be:
    (a) certain financial instruments would continue to be unrecognised in the financial statements of small entities, yet this information is relevant to a true and fair view;

[33] https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Impact-Assessment-FRS-100,-FRS-101-and-FRS-102.pdf

(b) small entities would be applying an accounting standard derived from other standards that were no longer in issue;

(c) small entities should now look to FRS 102 to determine new accounting policies for matters not addressed by the FRSSE, which will make it difficult for the FRSSE to continue without its application being influenced by FRS 102;

(d) preparers, advisors, auditors and users of financial statements will need to maintain familiarity with different accounting standards that are not derived from the same common framework, which in the long run is likely to increase education and training costs.

15. The FRC decided not to update the FRSSE.

This consultation document is issued by the Financial Reporting Council for comment.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy to:

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Comments should be despatched so as to be received no later than 30 November 2014.

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The FRC aims to publish responses within 10 working days of receipt.

The FRC will publish a summary of the consultation responses, either as part of, or alongside, its final decision.

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