Exposure Draft

Financial Reporting Council

February 2015

FRED 58

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

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Contents

Summary

(i) In 2012, 2013 and 2014 the Financial Reporting Council (FRC) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing the extant standards with four Financial Reporting Standards:

- (a) FRS 100 *Application of Financial Reporting Requirements*;
- (b) FRS 101 *Reduced Disclosure Framework*;
- (c) FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and
- (d) FRS 103 *Insurance Contracts.*

This Financial Reporting Exposure Draft (FRED) proposes adding another standard to this suite, draft FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*.

(ii) The revisions made by the FRC followed a sustained and detailed period of consultation. The FRC made these fundamental changes recognising that the introduction of International Financial Reporting Standards for listed groups in 2002 (with application from 2005) called into question the need for two sets of financial reporting standards. Evidence from consultation supported a move towards an international-based framework for financial reporting, but one that was proportionate to the needs of preparers and users.

(iii) The FRC's overriding objective in setting accounting standards 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.

(iv) In meeting this objective, the FRC aims to provide succinct financial reporting standards that:

- (a) have consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
- (b) reflect up-to-date thinking and developments in the way entities operate and the transactions they undertake;
- (c) balance consistent principles for accounting by all UK and Republic of Ireland entities with practical solutions, based on size, complexity, public interest and users' information needs;
- (d) promote efficiency within groups; and
- (e) are cost-effective to apply.

Draft FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*

(v) In November 2013, *The Small Companies (Micro-entities' Accounts) Regulations 2013* (SI 2013/3008) (the Micro-entities Accounts Regulations) were made and introduced into law an optional reduced reporting framework for companies that:

  (a) qualify as micro-entities as defined in section 393(1A) of the Companies Act 2006 (the Act); and

  (b) choose to apply the micro-entities regime.

(vi) If a company that qualifies for the micro-entities regime chooses not to apply it, the company should apply another accounting standard which is suitable for its particular circumstances and for which it is eligible.

(vii) The FRC issued a Consultation Document *Accounting Standards for small entities – Implementation of the EU Accounting Directive* in September 2014 which, inter alia, consulted on the future of accounting standards for micro-entities. This FRED takes into account the feedback from that consultation which indicated strong support for the development of a new standard for companies applying the micro-entities regime, based on the recognition and measurement requirements of FRS 102.

(viii) Draft FRS 105 has been developed from the recognition and measurement requirements of FRS 102, reflecting the proposed amendments to FRS 102 as set out in FRED 59 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Small entities and other minor amendments* where relevant. FRED 59 has been developed on the basis of the draft *The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015* which were laid before Parliament in January 2015. The final amendments to FRS 102, and consequently the final version of FRS 105, will not be issued until the legislation has been made and will take into account any relevant developments in the intervening period.

(ix) Draft FRS 105 is a single financial reporting standard that applies to the preparation of individual financial statements of companies that qualify as micro-entities and choose to apply the Micro-entities Regime. It aims to provide micro-entities with succinct financial reporting requirements and includes requirements for the most common and relevant transactions. If transactions are not addressed by this draft FRS either directly or by cross-reference to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, a micro-entity is not required to refer to FRS 102 in selecting its accounting policies.

(x) Draft FRS 105 includes the presentation and disclosure requirements of the micro-entities regime. The recognition and measurement requirements in this draft FRS are based on FRS 102; however, in developing draft FRS 105, FRS 102 has been amended within the context of the legal framework for micro-entity financial statements for the following:

  (a) To remove requirements that are not applicable because the requirements relate to:

    (i) the financial statements of entities that do not qualify to apply the micro-entities regime such as charities and financial institutions[1]; and

    (ii) the preparation of consolidated financial statements[2].

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1 See section 384B(2) of the Companies Act.

2 The micro-entities regime cannot be applied to the financial statements of a parent company that prepares consolidated financial statements or to the financial statements of non-parent companies where their accounts are included in consolidated financial statements (see section 384B(2) of the Companies Act).

(b) To remove those recognition and measurement requirements that are not permitted by law, for example:

   (i) revaluations of property, plant and equipment and intangible assets[3]; and

   (ii) fair value accounting for investment property and financial instruments[4].

(c) To remove all disclosure requirements other than those required by law, however a micro-entity is not prohibited from providing additional voluntary disclosures.

(d) To exempt micro-entities from having to account for some complex transactions, such as equity-settled share-based payments and deferred tax.

(e) To remove those requirements that relate to transactions that the FRC considers are confined to a small proportion of entities of this size such as trade and asset acquisitions, accounting for foreign branches, hyperinflation and certain specialised activities. In some instances, draft FRS 105 cross-refers to the relevant requirements of FRS 102, in others it is silent. Where there is a cross-reference to FRS 102, micro-entities should apply the relevant requirements from FRS 102 (excluding any disclosure requirements). Where draft FRS 105 is silent, micro-entities should refer to the principles, definitions, recognition criteria and measurement concepts set out in Section 2 *Concepts and Pervasive Principles* in determining their accounting policies.

(f) To simplify those requirements that the FRC considers to be too complex for entities of this size and where an alternative accounting treatment is available that would provide relevant and reliable information, such as for defined benefit pension scheme accounting.

(g) To remove any remaining accounting policy options to simplify application of the standard for preparers, and to avoid confusion for users due to the condensed format of micro-entities' financial statements and the lack of supporting disclosures to explain the accounting policies chosen.

Residents' management companies (FRED 50)

(xi) FRED 58 includes the Accounting Council's advice on the preparation of financial statements of residents' management companies following consideration of responses to FRED 50 *Draft FRC Abstract Residential Management Companies' Financial Statements and Consequential Amendments to the FRSSE* and the Consultation Document.

Organisation of draft FRS 105

(xii) Draft FRS 105 is organised by topic with each topic presented in a separate numbered section. Cross-references to paragraphs are identified by section followed by paragraph number. Paragraph numbers are in the form of xx.yy, where xx is the section number and yy is the sequential paragraph number within that section.

(xiii) In order to maintain consistency with the paragraph numbering of FRS 102, where a paragraph from FRS 102 has been deleted and not replaced with an alternative paragraph in draft FRS 105, the phrase "[not used]" is given.

(xiv) In examples that include monetary amounts, the measuring unit is Currency Unit (abbreviated as CU).

(xv) All the paragraphs of draft FRS 105 have equal authority. Some sections include appendices of implementation guidance or examples. Some of these are an integral part

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[3] Micro-entities are not permitted to use the Alternative Accounting rules (see paragraph 3(1A) of Part 2 to the Small Company Regulations).

[4] Micro-entities are not permitted to use the Fair Value rules (see paragraph 3(1A) of Part 2 to the Small Company Regulations).

of this draft FRS while others provide guidance concerning its application; each specifies its status.

(xvi) Draft FRS 105 is set out in Sections 1 to 35 (where applicable) and the Glossary (Appendix I). Terms defined in the glossary are in **bold type** the first time they appear in each section.

(xvii) Where references to other sections or paragraphs are made, these are in reference to draft FRS 105 unless otherwise stated.

Invitation to comment

1 The FRC is requesting comments on FRED 58 by 30 April 2015. 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 this FRED. In particular, comments are sought in relation to the questions below.

2 Information on how to submit comments and the FRC's policy in relation to responses is set out on page 136.

It is recommended that respondents read the Accounting Council's Advice to the FRC to issue FRED 58 for further explanations of the amendments and adaptations made to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* in developing draft FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* to ensure compliance with the legal framework, and the additional simplifications proposed.

As noted in the Summary to this FRED, respondents to the FRC's Consultation Document *Accounting standards for small entities – Implementation of the EU Accounting Directive* indicated strong support for the development of a new financial reporting standard for companies applying the micro-entities regime, based on the recognition and measurement requirements of FRS 102.

Structure and language of draft FRS 105

Question 1

In adapting FRS 102 to create draft FRS 105, it is necessary to strike a careful balance between developing an accounting standard that:

(a) is easily accessible and understandable for preparers of financial statements of entities of this size; yet

(b) maintains consistency with:

- (i) the language and terminology of FRS 102 (where the underlying recognition and measurement requirements of the two standards are the same); and
- (ii) the structure (ie the section and paragraph numbering) of FRS 102 upon which draft FRS 105 is based.

The advantages of maintaining consistency of structure and language with FRS 102 include:

(a) increasing comparability in financial reporting between entities reporting under different UK accounting standards; and

(b) reducing education and training costs for preparers, advisors, auditors and users of financial statements.

The FRC anticipates that entities that do not expect (or wish) to grow outside the qualifying limits of the micro-entities regime are more likely to favour simplicity of structure and language and will not be concerned with consistency with FRS 102; whereas entities that do expect to grow and move through the different reporting frameworks over time, and practitioners and advisors that have a range of clients reporting under different frameworks, are more likely to favour consistency of structure and language across the suite of UK standards.

Draft FRS 105 has been developed with this consistency in mind and this FRED presents the draft standard such that the language and terminology of FRS 102 (where the underlying recognition and measurement requirements of draft FRS 105 are the same), and the section and paragraph numbering of FRS 102, has been maintained. Those sections and paragraphs that have been deleted (either because of legal compliance (see Question 2) or because further recognition and measurement simplifications have been introduced (see Questions 3 to 8)) are replaced with the term "[not used]". Where the recognition and measurement requirements have been simplified in draft FRS 105, this consistency has not necessarily been maintained.

Do you agree with this approach? If not, why not? What alternative presentation do you propose?

Legal requirements

Question 2

The proposed amendments to align the requirements of draft FRS 105 with company law are discussed in more detail in paragraphs 19 to 31 of the Accounting Council's Advice.

Do you agree that draft FRS 105 accurately reflects the legal requirements and exemptions of the Micro-entities Regime including:

(a) Its scope?

(b) The presentation and formats of financial statements?

(c) The prohibition of the use of the Alternative Accounting Rules and Fair Value Rules?

(d) The disclosure exemptions?

If not, why not? What further amendments are required?

Additional simplifications to recognition and measurement requirements

Question 3 – Principles for simplifications

The Accounting Council used the following principles in considering whether further simplifications over and above the legal requirements would be appropriate in draft FRS 105:

(a) if the burden of applying the accounting treatment in FRS 102 is not outweighed by the benefits for micro-entities and an alternative, more straightforward, treatment could be identified;

(b) if the lack of detail in the formats of the financial statements and/or supporting disclosures would limit the understanding of the financial information presented; and/or

(c) if transactions occur infrequently amongst micro-entities.

Paragraphs 32 to 35 of the Accounting Council's Advice provide further detail.

Do you agree with these overarching principles and the resulting simplifications proposed in draft FRS 105? If not, why not?

Specifically:

Question 4 – Financial Instruments (Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*)

The micro-entities regime prohibits the subsequent measurement of assets and liabilities at fair value, therefore financial instruments are measured at cost or amortised cost. Draft FRS 105 proposes a number of further simplifications over and above these legal requirements (see Section 11 *Basic Financial Instruments*).

Paragraphs 44 to 50 of the Accounting Council's Advice provide further details.

Do you agree with this approach? If not, why not?

Do you believe further simplifications are necessary for micro-entities? If so, please provide further details.

Question 5 – Capitalisation of development costs (Section 18 *Intangible Assets other than Goodwill*) and borrowing costs (Section 25 *Borrowing Costs*)

Draft FRS 105 proposes to remove the accounting policy options from FRS 102 in relation to the capitalisation of borrowing costs (Section 25 *Borrowing Costs*) and development costs (Section 18 *Intangible Assets other than Goodwill)*. The proposed mandatory treatment will be to expense both borrowing and development costs.

Paragraphs 42 to 43 of the Accounting Council's Advice provide further details.

Do you agree with this approach? If not, why not?

Question 6 – Government grants (Section 24 *Government Grants)*

Draft FRS 105 removes the accounting policy option from FRS 102 in relation to the treatment of government grants (Section 24 *Government Grants*). The proposed mandatory treatment will be to apply the performance method.

Paragraphs 42 to 43 of the Accounting Council's Advice provide further details.

Do you agree with this approach? If not, why not? Alternatives would be to continue to permit the accounting policy choice (ie FRS 105 would allow a choice between the accruals method and the performance method) or to require the accruals method.

Question 7 – Simplifications via cross-referencing to requirements in FRS 102

There are a number of areas within draft FRS 105 where it is proposed that the detailed requirements for a particular type of transaction are removed but a cross-reference to FRS 102 is inserted for micro-entities that have these types of transactions, on the basis that these types of transactions occur infrequently amongst the majority of micro-entities.

The areas where this approach has been proposed include:

(a) intermediate payment arrangements (Section 9 *Consolidated and Separate Financial Statement*);

(b) trade and asset acquisitions (Section 19 *Business Combinations*);

(c) puttable instruments and examples of compound financial instruments (Section 22 *Liabilities and Equity*);

(d) cash-generating units (Section 27 *Impairment of assets*); and

(e) foreign branches (Section 30 *Foreign Currency Translation*).

Do you agree with this proposed approach in general, and specifically for these types of transactions? If not, why not? Alternatives would be to reproduce the requirements of FRS 102 within draft FRS 105 or for draft FRS 105 to be silent.

Question 8 – Other simplifications

Do you believe that any further accounting simplifications should 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 simplification should be made.

Residents' management companies (FRED 50)

Question 9

The FRC's Consultation Document proposed that a new sub-section is added to Section 34 *Specialised Activities* of FRS 102 for residents' management companies, setting out requirements that would be developed from the proposals set out in FRED 50 *Draft FRC Abstract 1 – Residential Management Companies' Financial Statements*.

Only some 32% of respondents to this question agreed with the proposal, with the rest disagreeing (50%) or providing some other response (18%).

The most compelling reasons given for not proceeding with the proposal were that:

(a) the issue is too narrow and industry-specific to be dealt with in an accounting standard and inclusion in Section 34 of FRS 102 would open up the FRC to specific requests that could result in the standard becoming unwieldy and difficult to apply; and

(b) interpretations of law and accounting standards should be issued by other means with a significant number of respondents calling for an alternative solution such as sector-specific guidance developed by the FRC or the development of a Statement of Recommended Practice (SORP) by parties outside of the FRC.

In light of feedback received, the FRC now proposes that a clear statement of the legal position (ie that residents' management companies act as principals) should be included in the Accounting Council's Advice to the FRC (see paragraphs 54 to 59 of the Accounting Council's Advice). This clarification of the legal position should reduce the diversity in practice that currently exists because when an entity enters into transactions as a principal, such transactions should be recorded in its accounts.

Do you agree with this approach? If not, why not? What alternative approach do you propose?

Consultation Stage Impact Assessment

Question 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?

[Draft] FRS 105
The Financial Reporting Standard applicable to the Micro-entities Regime

Section 1
Scope

Scope of this Financial Reporting Standard

1.1 This [draft] FRS applies to the financial statements of a company that is preparing its financial statements in accordance with the **micro-entities regime**.

1.2 The requirements of this [draft] FRS are only applicable to companies that qualify as **micro-entities** (as defined by section 384A of the **Act**) and choose to apply the micro-entities regime. Therefore entities that are not established under company law are not eligible to apply the micro-entities regime. Entities excluded from being treated as micro-entities (as defined by section 384B(1) of the Act) (for example financial institutions, insurance undertakings and charities) are not permitted to apply this [draft] FRS.

1.2A [Not used]

1.2B This [draft] FRS does not apply to the financial statements of a reporting entity if the entity is a **parent** company which prepares **consolidated financial statements** or the company is not a parent company but its accounts are included in consolidated financial statements (as set out in section 384B(2) of the Act).

1.3 to 1.13 [Not used]

Date from which effective and transitional arrangements

1.14 A micro-entity applying the micro-entities regime shall apply this [draft] FRS for accounting periods beginning on or after 1 January 2016. Early application is permitted.

1.15 [Not used]

Section 1A
Small Entities

[Not used]

Section 2
Concepts and Pervasive Principles

Scope of this section

2.1 This section sets out the concepts and basic principles that generally underlie the **recognition** and **measurement** of transactions of **micro-entities** within the scope of this [draft] FRS.

2.1A to 2.8 [Not used]

2.9 [Moved to 2.27A]

2.10 to 2.14 [Not used]

Financial position

2.15 The **financial position** of a micro-entity is the relationship of its **assets**, **liabilities** and **equity** as of a specific date as presented in the **statement of financial position**. These are defined as follows:

(a) An asset is a resource controlled by the micro-entity as a result of past events and from which future economic benefits are expected to flow to the micro-entity.

(b) A liability is a present obligation of the micro-entity arising from past events, the settlement of which is expected to result in an outflow from the micro-entity of resources embodying economic benefits.

(c) Equity is the residual interest in the assets of the micro-entity after deducting all its liabilities.

2.16 Some items that meet the definition of an asset or a liability may not be recognised as assets or liabilities in the statement of financial position because they do not satisfy the criteria for recognition in paragraphs 2.27 to 2.32. In particular, the expectation that future economic benefits will flow to or from a micro-entity must be sufficiently certain to meet the probability criterion before an asset or liability is recognised.

Assets

2.17 The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of cash to the micro-entity. Those cash flows may come from using the asset or from disposing of it.

2.18 Many assets, for example **property, plant and equipment**, have a physical form. However, physical form is not essential to the existence of an asset. Some assets are intangible.

2.19 In determining the existence of an asset, the right of ownership is not essential. Thus, for example, property held on a **lease** is an asset if the micro-entity controls the benefits that are expected to flow from the property.

Liabilities

2.20 An essential characteristic of a liability is that the micro-entity has a present obligation to act or perform in a particular way. The obligation may be either a legal obligation or a **constructive obligation**. A legal obligation is legally enforceable as a consequence of a binding contract or statutory requirement. A constructive obligation is an obligation that derives from a micro-entity's actions when:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the micro-entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the micro-entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

2.21 The settlement of a present obligation usually involves the payment of cash, transfer of other assets, provision of services, the replacement of that obligation with another obligation, or conversion of the obligation to equity. An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

Equity

2.22 Equity is the residual interest in the assets of the micro-entity after deducting all its liabilities.

Performance

2.23 **Performance** is the relationship of the **income** and **expenses** of a micro-entity during a **reporting period**. Income and expenses are defined as follows:

(a) Income is increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors.

(b) Expenses are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors.

2.24 The recognition of income and expenses results directly from the recognition and measurement of assets and liabilities. Criteria for the recognition of income and expenses are discussed in paragraphs 2.27 to 2.32.

Income

2.25 The definition of income encompasses both **revenue** and **gains**.

(a) Revenue is income that arises in the course of the ordinary activities of a micro-entity and is referred to by a variety of names including sales, fees, interest, dividends, royalties and rent.

(b) Gains are other items that meet the definition of income but are not revenue. When gains are recognised in the **income statement**, they are usually displayed separately because knowledge of them is useful for making economic decisions.

Expenses

2.26 The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the micro-entity.

(a) Expenses that arise in the course of the ordinary activities of the micro-entity include, for example, cost of sales, wages and **depreciation**. They usually take the form of an outflow or depletion of assets such as cash, **inventory**, or property, plant and equipment.

(b) Losses are other items that meet the definition of expenses and may arise in the course of the ordinary activities of the micro-entity. When losses are recognised in the income statement, they are usually presented separately because knowledge of them is useful for making economic decisions.

Recognition of assets, liabilities, income and expenses

2.27 Recognition is the process of incorporating in the statement of financial position or income statement an item that meets the definition of an asset, liability, equity, income or expense and satisfies the following criteria:

(a) it is **probable** that any future economic benefit associated with the item will flow to or from the micro-entity; and

(b) the item has a cost or value that can be measured reliably.

2.27A The uncertainties that inevitably surround many events and circumstances are acknowledged by the exercise of **prudence** in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or **income** are not overstated and **liabilities** or **expenses** are not understated. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias.

2.28 [Not used]

The probability of future economic benefit

2.29 The concept of probability is used in the first recognition criterion to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the micro-entity. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence relating to conditions at the end of the reporting period available when the financial statements are prepared. Those assessments are made individually for individually significant items, and for a group for a large population of individually insignificant items.

Reliability of measurement

2.30 The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, the cost or value of an item is known. In other cases it must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When a reasonable estimate cannot be made, the item is not recognised in the financial statements.

2.31 An item that fails to meet the recognition criteria may qualify for recognition at a later date as a result of subsequent circumstances or events.

2.32 An item that fails to meet the criteria for recognition may nonetheless warrant disclosure in the **notes** if required by Section 8 *Notes to the Financial Statements*.

Measurement of assets, liabilities, income and expenses

2.33 Measurement is the process of determining the monetary amounts at which a micro-entity measures assets, liabilities, income and expenses in its financial statements. Measurement involves the selection of a basis of measurement. This [draft] FRS specifies which measurement basis a micro-entity shall use for many types of assets, liabilities, income and expenses.

2.34 [Not used]

Pervasive recognition and measurement principles

2.35 The requirements for recognising and measuring assets, liabilities, income and expenses in this [draft] FRS are based on pervasive principles that are derived from the IASB *Framework for the Preparation and Presentation of Financial Statements*[5] and from **EU-adopted IFRS**. In the absence of a requirement in this [draft] FRS that applies specifically to a transaction or other event or condition, paragraph 10.4 provides guidance for making a judgement and paragraph 10.5 requires a micro-entity to look to the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles set out in this section.

Accrual basis

2.36 A micro-entity shall prepare its financial statements using the **accrual basis** of accounting. On the accrual basis, items are recognised as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for those items.

Recognition in financial statements

Assets

2.37 A micro-entity shall recognise an asset in the statement of financial position when it is probable that the future economic benefits will flow to the micro-entity and the asset has a cost or value that can be measured reliably. An asset is not recognised in the statement of financial position when expenditure has been incurred for which it is considered not probable that economic benefits will flow to the micro-entity beyond the current reporting period. Instead such a transaction results in the recognition of an expense in the income statement.

2.38 A micro-entity shall not recognise a **contingent asset** as an asset. However, when the flow of future economic benefits to the micro-entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

Liabilities

2.39 A micro-entity shall recognise a liability in the statement of financial position when:

(a) the micro-entity has an obligation at the end of the reporting period as a result of a past event;

(b) it is probable that the micro-entity will be required to transfer resources embodying economic benefits in settlement; and

(c) the settlement amount can be measured reliably.

2.40 A **contingent liability** is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 2.39.

[5] In 2010 the IASB issued the *Conceptual Framework for Financial Reporting*, which superseded the *Framework for the Preparation and Presentation of Financial Statements*.

Income

2.41 The recognition of income results directly from the recognition and measurement of assets and liabilities. A micro-entity shall recognise income in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

Expenses

2.42 The recognition of expenses results directly from the recognition and measurement of assets and liabilities. A micro-entity shall recognise expenses in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

Profit or loss

2.43 [Not used]

2.44 **Profit or loss** is the arithmetical difference between income and expenses. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.

2.45 Generally this [draft] FRS does not allow the recognition of items in the statement of financial position that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the 'matching concept' for measuring profit or loss.

Measurement at initial recognition

2.46 At initial recognition, a micro-entity shall measure assets and liabilities at historical cost unless this [draft] FRS requires initial measurement (usually where a cost is not known) on another basis such as **fair value**. For example, this [draft] FRS requires inventory acquired in a **non-exchange transaction** and property, plant and equipment acquired in whole or part in exchange for non-monetary asset(s) to be measured initially at fair value.

2.46A Where determination of a fair value is required, a micro-entity shall use the following hierarchy to estimate the fair value of the asset or liability:

(a) The best evidence of fair value is the open market price for an identical asset or liability in an **active market**.

(b) Where this is not available, the price of a recent transaction for an identical asset or liability provides evidence of fair value as long as there has not been significant change in economic circumstances or a significant lapse of time since the transaction took place.

(c) If neither (a) or (b) above are available, the fair value shall be estimated using a valuation technique.

Subsequent measurement

Financial assets and financial liabilities

2.47 A micro-entity measures **financial assets** and **financial liabilities** at either cost less accumulated **impairment losses** or **amortised cost**.

2.48 [Not used]

Non-financial assets

2.49 Some non-financial assets that have initially been recognised at historical cost or fair value may be subsequently measured on other measurement bases, for example inventories are subsequently measured at the lower of cost and selling price less costs to complete and sell.

Measurement of assets at amounts lower than initial historical cost is intended to ensure that an asset is not measured at an amount greater than the micro-entity expects to recover from the sale or use of that asset.

2.50 [Not used]

Liabilities other than financial liabilities

2.51 Most liabilities other than financial liabilities are measured at the best estimate of the amount that would be required to settle the obligation at the **reporting date**.

Offsetting

2.52 A micro-entity shall not offset assets and liabilities, or income and expenses, unless required or permitted by this [draft] FRS.

(a) Measuring assets net of valuation allowances (for example, allowances for inventory obsolescence and allowances for uncollectible receivables) is not offsetting.

(b) If a micro-entity's normal **operating activities** do not include buying and selling **fixed assets**, including investments and operating assets, then the micro-entity reports gains and losses on disposal of such assets by deducting from the proceeds on disposal the **carrying amount** of the asset and related selling expenses.

Section 3
Financial Statement Presentation

Scope of this section

3.1 This section explains what compliance with this [draft] FRS requires and what makes up a complete set of financial statements for a **micro-entity**.

3.1A [Not used]

True and fair view

3.2 Financial statements prepared in accordance with the micro-entities provisions of the **Act** and **Small Companies Regulations** are presumed to give a true and fair view of the **financial position** and financial **performance** of a micro-entity.

Compliance with the Micro-entities Accounts Regulations

3.3 For a micro-entity whose financial statements comply with the micro-entities provisions of the Act and Small Companies Regulations, the **statement of financial position** must contain, in a prominent position above the signature, the statement that the financial statements are prepared in accordance with the micro-entity provisions of the Act and Small Companies Regulations.

PBE3.3A to 3.7 [Not used]

Going concern

3.8 When preparing financial statements, the management of a micro-entity using this [draft] FRS shall make an assessment of the micro-entity's ability to continue as a **going concern**. A micro-entity is a going concern unless management either intends to liquidate the micro-entity or to cease trading, or has no realistic alternative but to do so. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue.

3.9 [Not used]

Frequency of reporting

3.10 A micro-entity shall present a complete set of financial statements (including comparative information as set out in paragraph 3.14) at the end of each **reporting period**.

Consistency of presentation

3.11 A micro-entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

(a) it is apparent, following a significant change in the nature of the micro-entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of **accounting policies** in Section 10 *Accounting Policies, Estimates and Errors*; or

(b) this [draft] FRS requires a change in presentation.

3.12 When the presentation or classification of items in the financial statements is changed, a micro-entity shall reclassify comparative amounts unless the reclassification is **impracticable**.

3.13 [Not used]

Comparative information

3.14 Except when this [draft] FRS permits or requires otherwise, a micro-entity shall present comparative information in respect of the preceding period for all amounts presented in the current period's financial statements.

Materiality and aggregation

3.15 to 3.16 [Not used]

3.16A A micro-entity need not provide a specific disclosure required by this [draft] FRS if the information is not **material**.

Complete set of financial statements

3.17 A complete set of financial statements of a micro-entity shall include the following:

(a) a statement of financial position as at the **reporting date** with **notes** included at the foot of the statement; and

(b) an **income statement**.

3.18 to 3.19 [Not used]

3.20 Because paragraph 3.14 requires comparative amounts in respect of the previous period for all amounts presented in the financial statements, a complete set of financial statements means that a micro-entity shall present, as a minimum, two of each of the required financial statements and related notes.

3.21 In a complete set of financial statements, a micro-entity shall present each financial statement with equal prominence.

3.22 A micro-entity may use titles for the financial statements other than those used in this [draft] FRS as long as they are not misleading.

Identification of the financial statements

3.23 A micro-entity shall clearly identify each of the financial statements and the notes. In addition, a micro-entity shall display the following information prominently, and repeat it when necessary for an understanding of the information presented:

(a) the name of the reporting entity and any change in its name since the end of the preceding reporting period;

(b) [Not used]

(c) the date of the end of the reporting period and the period covered by the financial statements;

(d) the presentation currency; and

(e) the level of rounding, if any, used in presenting amounts in the financial statements.

3.24 to 3.25 [Not used]

Section 4
Statement of Financial Position

Scope of this section

4.1 This section sets out the information that is to be presented in a **statement of financial position** and how to present it. The statement of financial position (which is referred to as the balance sheet in the **Act**) presents a **micro-entity's assets, liabilities** and **equity** as of a specific date—the end of the **reporting period**.

4.1A [Not used]

Information to be presented in the statement of financial position

4.2 A micro-entity shall present a statement of financial position in accordance with one of the formats set out in Section C of Part 1 of Schedule 1 to the **Small Companies Regulations**, as follows:

Format 1		**CU**	**CU**
A	Called up share capital not paid		X
B	Fixed assets		X
C	Current assets	X	
D	Prepayments and accrued income	X	
E	Creditors: amounts falling due within one year	(X)	
F	Net current assets / (liabilities)		X/(X)
G	Total assets less current liabilities		X
H	Creditors: amounts falling due after more than one year		(X)
I	Provisions for liabilities		(X)
J	Accruals and deferred income		(X)
			X
K	Capital and reserves		X

Format 2		**CU**
Assets		
A	Called up share capital not paid	X
B	Fixed assets	X
C	Current assets	X
D	Prepayments and accrued income	X
		X
Liabilities		
A	Capital and reserves	X
B	Provisions for liabilities	X
C	Creditors[6]	X
D	Accruals and deferred income	X
		X

4.2A to 4.6 [Not used]

Creditors: amounts falling due within one year

4.7 A micro-entity shall classify a creditor as due within one year when the micro-entity does not have an unconditional right, at the end of the reporting period, to defer settlement of the creditor for at least twelve months after the **reporting date**.

4.8 to 4.14 [Not used]

[6] Aggregate amounts falling due within one year and after one year must be shown separately.

Section 5
Income Statement

Scope of this section

5.1 This section requires a **micro-entity** to present its **profit or loss** for a period, ie its financial **performance** for the period. It sets out the information that is to be presented in the **income statement** (which is referred to as the profit and loss account in the **Act**) and how to present it.

5.1A [Not used]

Presentation of profit or loss

5.2 A micro-entity shall present its profit or loss for a period in an **income statement** in accordance with Section C of Part 1 of Schedule 1 to the **Small Companies Regulations**, as follows:

		CU
A	Turnover	X
B	Other income	X
C	Cost of raw materials and consumables	(X)
D	Staff costs	(X)
E	Depreciation and other amounts written off assets	(X)
F	Other charges	(X)
G	Tax	(X)
H	Profit or loss	X / (X)

5.3 to 5.7F [Not used]

5.8 Under this [draft] FRS, the effects of corrections of **material errors** and changes in **accounting policies** are presented as retrospective adjustments of prior periods rather than as part of profit or loss in the period in which they arise (see Section 10 *Accounting Policies, Estimates and Errors*).

5.9 to 5.11 [Not used]

Section 6
Statement of Changes in Equity and Statement of Income and Retained Earnings

[Not used]

Section 7
Statement of Cash Flows

[Not used]

Section 8
Notes to the Financial Statements

Scope of this section

8.1 This section sets out the information that shall be disclosed in the **notes** to the financial statements and where.

Structure and content of the notes

8.2 In accordance with section 472(1A) of the **Act**, the notes to the financial statements of a **micro-entity** shall be presented at the foot of the **statement of financial position**.

8.3 to 8.7 [Not used]

8.8 In accordance with paragraph 1A of Section 472 of the Act, a micro-entity shall disclose the following information in relation to financial commitments, guarantees and contingencies:

(a) the total amount of any financial commitments, guarantees or contingencies that are not included in the statement of financial position;

(b) an indication of the nature and form of any valuable security which has been provided; and

(c) any commitments concerning pensions and affiliated or associated undertakings shall also be disclosed separately.

For example, a micro-entity may have pledged **financial assets**, **property**, **plant and equipment** or **intangible assets** as security (see paragraphs 11.46, 17.32 and 18.28), have financial commitments in relation to **operating leases** (see paragraph 20.16) and/or **contingent liabilities** and **contingent assets** (see paragraphs 21.15 and 21.16) that have not been recognised in the statement of financial position. Micro-entities that participate in **multi-employer pension plans** may be required to provide the disclosure set out in paragraph 28.40A.

8.9 In accordance with paragraph 1A of Section 472 of the Act, a micro-entity shall disclose the following information in relation to advances and credits granted to management[7]:

(a) the amount of advances and credits granted to members of the administrative, managerial and supervisory bodies with indications of the interest rates, main conditions and any amounts repaid or written off or waived; and

(b) any commitments entered into on their behalf by way of guarantees of any kind, with an indication of the total for each category.

[7] Although Section 33 *Related Party Disclosures* is not used in this [draft] FRS, micro-entities are required by law to provide the disclosures required by paragraph 8.9.

Section 9
Consolidated and Separate Financial Statements

Scope of this section

9.1 This section applies to the accounting for investments in **subsidiaries** and intermediate payment arrangements in the financial statements of a **micro-entity**.

9.2 to 9.26 [Not used]

9.26A A micro-entity shall refer to Section 11 *Basic Financial Instruments* which sets out the requirements for all investments in shares, including investments in subsidiaries.

9.27 to 9.32 [Not used]

Intermediate payment arrangements (eg ESOPs)

9.33 Intermediate payment arrangements may take a variety of forms. Examples of intermediate payment arrangements include employee share ownership plans (ESOPs) and employee benefit trusts that are used to facilitate employee shareholdings under remuneration schemes. In a typical employee benefit trust arrangement for **share-based payment transactions**, a micro-entity makes payments to a trust or guarantees borrowing by the trust, and the trust uses its funds to accumulate **assets** to pay the micro-entity's employees for services the employees have rendered to the micro-entity. Paragraph 9.33 of **FRS 102** provides further guidance.

Accounting for intermediate payment arrangements

9.34 When a micro-entity participates in intermediate payment arrangements, the micro-entity shall apply the requirements of paragraphs 9.34 to 9.37 of FRS 102.

9.35 to 9.38 [Not used]

Section 10
Accounting Policies, Estimates and Errors

Scope of this section

10.1 This section provides guidance for selecting and applying the **accounting policies** used in preparing financial statements. It also covers **changes in accounting estimates** and corrections of **errors** in prior period financial statements.

Selection and application of accounting policies

10.2 Accounting policies are the specific principles, bases, conventions, rules and practices applied by a **micro-entity** in preparing and presenting financial statements.

10.3 If this [draft] FRS specifically addresses a transaction, other event or condition, a micro-entity shall apply this [draft] FRS. However, the micro-entity need not follow a requirement in this [draft] FRS if the effect of doing so would not be **material**.

10.4 If this [draft] FRS does not specifically address a transaction, other event or condition, a micro-entity's management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and

(b) reliable, in that the financial statements:

(i) represent faithfully the **financial position** and financial **performance** of the micro-entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects.

10.5 In making the judgement described in paragraph 10.4, management shall refer to and consider the definitions, **recognition** criteria and **measurement** concepts for **assets**, **liabilities**, **income** and **expenses** and the pervasive principles in Section 2 *Concepts and Pervasive Principles*. In considering these concepts and principles, a micro-entity needs only to provide the disclosures required by Section 8 *Notes to the Financial Statements* in order for its financial statements to be presumed to give a true and fair view.

10.6 [Not used]

Consistency of accounting policies

10.7 A micro-entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions.

Changes in accounting policies

10.8 A micro-entity shall change an accounting policy only if the change:

(a) is required by this [draft] FRS; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the micro-entity's financial position and financial performance.

10.9 The following are not changes in accounting policies:

(a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and

(b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were not material.

(c) [Not used]

10.10 to 10.10A [Not used]

Applying changes in accounting policies

10.11 A micro-entity shall account for changes in accounting policy as follows:

(a) a micro-entity shall account for a change in accounting policy resulting from a change in the requirements of this [draft] FRS in accordance with the transitional provisions, if any, specified in that amendment; and

(b) a micro-entity shall account for all other changes in accounting policy retrospectively (see paragraph 10.12).

Retrospective application

10.12 When a change in accounting policy is applied retrospectively in accordance with paragraph 10.11, the micro-entity shall apply the new accounting policy to comparative information for prior periods to the earliest date for which it is practicable, as if the new accounting policy had always been applied. When it is **impracticable** to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, the micro-entity shall apply the new accounting policy to the **carrying amounts** of assets and liabilities as at the beginning of the earliest period for which **retrospective application** is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of **equity** for that period.

10.13 to 10.14 [Not used]

Changes in accounting estimates

10.15 A **change in accounting estimate** is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

10.16 A micro-entity shall recognise the effect of a change in an accounting estimate, other than a change to which paragraph 10.17 applies, **prospectively** by including it in **profit or loss** in:

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

10.17 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, the micro-entity shall recognise it by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

10.18 [Not used]

Corrections of prior period errors

10.19 Prior period errors are omissions from, and misstatements in, a micro-entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

10.20 Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

10.21 To the extent practicable, a micro-entity shall correct a material prior period error retrospectively in the first financial statements authorised for issue after its discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

10.22 When it is impracticable to determine the period-specific effects of a material error on comparative information for one or more prior periods presented, the micro-entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).

10.23 [Not used]

Section 11
Basic Financial Instruments

Scope of Sections 11 and 12

11.1 Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* together deal with the **recognition**, **derecognition**, **measurement** and disclosure of **financial instruments** (**financial assets** and **financial liabilities**).

PBE11.1A to 11.4 [Not used]

Scope of Section 11

11.5 All financial instruments are accounted for in accordance with this section, unless they are excluded because they fall within the scope of another section of this [draft] FRS (see paragraph 11.7). Examples of financial instruments in the scope of this section include:

(a) cash;

(b) accounts receivable and payable (trade debtors and creditors);

(c) commercial paper and commercial bills held;

(d) demand and fixed-term deposits with banks or similar institutions;

(e) bonds, loans and similar instruments;

(f) investments in **subsidiaries**, **associates** and **jointly controlled entities**; and

(g) investments in **ordinary shares** and preference shares.

11.6 [Not used]

11.7 This section does not apply to the following financial instruments:

(a) Financial instruments within the scope of Section 12.

(b) Financial instruments that meet the definition of a **micro-entity's** own **equity**, and the equity component of **compound financial instruments** issued by the reporting micro-entity that contain both a **liability** and an equity component (see Section 22 *Liabilities and Equity)*.

(c) **Leases**, to which Section 20 *Leases* applies. However, the **derecognition** requirements in paragraphs 11.36 to 11.38 and impairment accounting requirements in paragraphs 11.21 to 11.26 apply to derecognition and impairment of receivables recognised by a lessor and the derecognition requirements in paragraphs 11.36 to 11.38 apply to payables recognised by a lessee arising under a **finance lease**.

(d) Employers' rights and obligations under employee benefit plans, to which Section 28 *Employee Benefits* applies.

(e) Financial instruments, contracts and obligations to which Section 26 *Share-based Payment* applies.

(f) [Not used]

(g) [Not used]

(h) Reimbursement assets accounted for in accordance with Section 21 *Provisions and Contingencies.*

(i) **Financial guarantee contracts** (see Section 21).

11.8 to 11.11 [Not used]

Initial recognition of financial assets and liabilities

11.12 A micro-entity shall recognise a financial asset or a financial liability only when the micro-entity becomes a party to the contractual provisions of the instrument.

Initial measurement

11.13 When a financial asset or financial liability is recognised initially, a micro-entity shall measure it at the transaction price, plus or minus any **transaction costs** that have not been recognised in **profit or loss** immediately (see paragraph 11.15).

11.13A The transaction price is normally the amount borrowed or loaned in the case of loans, the cash price receivable or payable in the case of trade receivables or payables or the consideration given in the case of an investment.

11.13B Transaction costs may be recognised immediately in profit or loss if they are considered not **material**.

11.13C When a micro-entity purchases **inventory**, **investment property**, **property**, **plant and equipment** or sells goods or services with settlement deferred beyond normal credit terms, the transaction price is the cash price available on the date of the transaction (see Sections 13 *Inventories*, 16 *Investment Property*, 17 *Property, Plant and Equipment* and 23 *Revenue* respectively).

Subsequent measurement

11.14 At the end of each **reporting period**, a micro-entity shall measure financial instruments as follows, without any deduction for transaction costs the micro-entity may incur on sale or other disposal:

(a) Investments in preference shares or ordinary shares shall be measured at cost less impairment.

(b) Investments in subsidiaries, associates and jointly controlled entities shall be measured at cost less impairment.

(c) [Not used]

(d) Financial instruments other than those covered by (a) and (b) shall be measured at **amortised cost**. Paragraphs 11.15 to 11.26 provide guidance on determining amortised cost.

All financial assets must be assessed for impairment or uncollectability. See paragraphs 11.21 to 11.26.

Transaction costs

11.14A A micro-entity shall recognise transaction costs in profit or loss on a straight line basis over the expected life of the instrument unless transaction costs are considered to be not material, in which case they may be recognised in profit or loss immediately in accordance with paragraph 11.13B.

Amortised cost

11.15 The amortised cost (for the purposes of this [draft] FRS) of a financial asset or financial liability is the net of the following amounts:

(a) the transaction price (see paragraphs 11.13 to 11.13C);

(b) plus, in the case of a financial asset, or minus in the case of a financial liability, transaction costs not yet recognised in profit or loss;

(c) plus the cumulative interest income or expense recognised in profit or loss to date (see paragraphs 11.16 and 11.16A);

(d) minus all repayments of principal and all interest payments or receipts to date;

(e) minus, in the case of a financial asset, any reduction (directly or through the use of an allowance account) for impairment or uncollectability.

Allocation of interest income or expense

11.16 Total interest income or expense is the difference between the initial transaction price and the total amount of the subsequent contractual receipts or payments.

11.16A A micro-entity shall allocate total interest income or expense to each reporting period on a systematic basis over the term of the contract. For transactions where settlement is deferred beyond normal credit terms (see paragraph 11.13C) interest income or expense shall be allocated on a straight-line basis over the term of the contract. In other cases, interest income or expense is allocated to each period at a constant rate, which will normally be the rate of interest applicable under the contract.

11.17 to 11.20 [Not used]

Impairment of financial instruments

Recognition and measurement

11.21 At the end of each reporting period, a micro-entity shall assess whether there is evidence of impairment of any financial assets.

11.22 Evidence that a financial asset could be impaired includes the following events:

(a) significant financial difficulty of the issuer or obligor;

(b) a breach of contract, such as a default or delinquency in interest or principal payments;

(c) the creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider;

(d) it has become **probable** that the debtor will enter bankruptcy or other financial reorganisation;

(e) [Not used]

(f) declining market values of the asset or similar assets; and

(g) significant changes with an adverse effect on the asset that have taken place in the technological, market, economic or legal environment.

11.23 to 11.24 [Not used]

11.25 A micro-entity shall recognise an **impairment loss** immediately in profit or loss. A micro-entity shall measure an impairment loss for financial assets within the scope of this section as follows:

(a) An asset measured at cost in accordance with paragraph 11.14(a) and (b) is impaired and an impairment loss shall be recognised, if the asset's **carrying amount** exceeds the best estimate of the asset's selling price as at the **reporting date**.

(b) An asset measured at amortised cost in accordance with paragraph 11.14(d), is impaired and an impairment loss shall be recognised, if the asset's carrying amount exceeds the **present value** of estimated net cash flows that can be generated from the asset.

Reversal

11.26 A micro-entity shall reverse a previously recognised impairment loss, if in a subsequent period the amount of an impairment loss decreases and the decrease can be related to an event occurring after the impairment was recognised (eg an improvement in the debtor's credit rating). The micro-entity shall recognise the amount of the reversal in profit or loss immediately.

11.27 to 11.32 [Not used]

Derecognition of a financial asset

11.33 A micro-entity shall derecognise a financial asset only when:

(a) the contractual rights to the cash flows from the financial asset expire or are settled; or

(b) the micro-entity transfers to another party substantially all of the risks (eg slow or non-payment risk) and rewards of ownership (eg future cash flows from a debtor).

11.34 If a micro-entity received any proceeds from the transfer of a financial asset, but the conditions in paragraph 11.33 are not met, a micro-entity shall continue to recognise the asset in its entirety and shall recognise a financial liability for the consideration received. The asset and liability shall not be offset. In subsequent periods, the micro-entity shall recognise any **income** on the transferred asset and any **expense** incurred on the financial liability.

Example: Debt factoring arrangement that qualifies for derecognition

A micro-entity sells a group of its accounts receivable to a bank at less than their face amount. The micro-entity is obliged to remit promptly to the bank all amounts collected, but it has no obligation to the bank for slow payment or non-payment by the debtors.

In this case, the micro-entity has transferred to the bank substantially all of the risks and rewards of ownership of the receivables. Accordingly, it removes the receivables from its statement of financial position (ie derecognises them), and it shows no liability in respect of the proceeds received from the bank. The micro-entity recognises a loss calculated as the difference between the carrying amount of the receivables at the time of sale and the proceeds received from the bank. The micro-entity recognises a liability to the extent that it has collected funds from the debtors but has not yet remitted them to the bank.

> **Example: Debt factoring arrangement that does not qualify for derecognition**
>
> The facts are the same as in the preceding example except that the micro-entity has agreed to buy back from the bank any receivables for which the debtor is in arrears as to principal or interest for more than 120 days.
>
> In this case, the micro-entity has retained the risk of slow payment or non-payment by the debtors – a significant risk with respect to receivables. Accordingly, the micro-entity does not treat the receivables as having been sold to the bank, and it does not derecognise them. Instead, it treats the proceeds from the bank as a loan. The micro-entity continues to recognise the receivables as an asset until they are collected or written off as uncollectible.

Transfers of non-cash collateral

11.35 When a micro-entity participates in arrangements where it provides or receives financial assets other than cash as collateral (eg a micro-entity pledges commercial papers as security against a loan), the micro-entity shall apply the requirements of paragraph 11.35(b) to 11.35(d) of **FRS 102**.

Derecognition of a financial liability

11.36 A micro-entity shall derecognise a financial liability (or a part of a financial liability) only when it is extinguished—ie when the obligation specified in the contract is discharged, is cancelled or expires.

11.37 If the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the borrower) are substantially modified (eg the life of the loan is substantially extended) the micro-entity shall account for the transaction as an extinguishment of the original financial liability and the recognition of a new financial liability.

11.38 The micro-entity shall recognise in profit or loss any difference between the carrying amount of the financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed.

Presentation

11.38A A financial asset and a financial liability shall be offset and the net amount presented in the **statement of financial position** when, and only when, a micro-entity:

(a) currently has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Disclosures

11.39 to 11.45 [Not used]

11.46 A micro-entity shall disclose the nature and form of any financial assets that are pledged as security in accordance with paragraph 8.8(b).

11.47 to 11.48C [Not used]

Section 12
Other Financial Instruments Issues

Scope of Sections 11 and 12

12.1 Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* together deal with the **recognition**, **derecognition**, **measurement** and disclosure of **financial instruments** (**financial assets** and **financial liabilities**).

PBE12.1A to 12.2A [Not used]

Scope of Section 12

12.3 This section applies to financial instruments with the following three characteristics:

(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable (sometimes called the 'underlying'), provided in the case of a non-financial variable that the variable is not specific to a party to the contract;

(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and

(c) it is settled at a future date.

12.4 Examples of financial instruments that normally meet the three characteristics include options, warrants, futures contracts, forward contracts and interest rate swaps.

12.5 This section does not apply to the following financial instruments:

(a) Financial instruments within the scope of Section 11.

(b) [Not used]

(c) Employers' rights and obligations under employee benefit plans to which Section 28 *Employee Benefits* applies.

(d) [Not used]

(e) Financial instruments that meet the definition of a **micro-entity's** own **equity** and the equity component of **compound financial instruments** issued by the reporting micro-entity that contain both a **liability** and an equity component (see Section 22 *Liabilities and Equity*).

(f) **Leases** to which Section 20 *Leases* applies.

(g) [Not used]

(h) [Not used]

(i) Financial instruments, contracts and obligations to which Section 26 *Share-based Payment* applies.

(j) [Not used]

(k) Reimbursement assets accounted for in accordance with Section 21 *Provisions and Contingencies.*

(l) **Financial guarantee contracts** (see Section 21).

Initial recognition

12.6 A micro-entity shall recognise a financial instrument only when the micro-entity becomes a party to the contractual provisions of a financial instrument.

12.6A A micro-entity shall recognise the cost of a financial instrument within the scope of this section as an **asset** if, and only if:

(a) it is **probable** that future economic benefits associated with a financial instrument will flow to the micro-entity; and

(b) the cost of a financial instrument can be measured reliably.

Initial measurement

12.7 When a financial instrument is recognised initially, a micro-entity shall measure it at its transaction price plus or minus **transaction costs**. Normally the transaction price is equal to the consideration given for a financial instrument. Transaction costs may be recognised immediately **in profit or loss** if they are considered not **material**.

Subsequent measurement

12.8 A micro-entity shall allocate the amount initially recognised for a financial instrument within the scope of this section to each **reporting period** on a systematic basis. This will normally be straight-line over the term of the contract.

Contractual payments

12.8A Payments due or receivable to settle the contractual obligations of a financial instrument within the scope of this section shall be accounted for in accordance with the applicable recognition and measurement requirements in Section 2 *Concepts and Pervasive Principles*, unless another section of this [draft] FRS sets out more specific requirements. A foreign currency contract that covers a trading transaction shall be accounted for in accordance with paragraph 30.7.

12.9 to 12.12 [Not used]

Impairment

12.13 At each **reporting date** the micro-entity shall determine whether a financial asset within the scope of this section is impaired and if so, recognise an **impairment loss**. The impairment loss shall not exceed the **carrying amount** of the asset. A financial asset is impaired if it is terminated early or becomes an **onerous contract** (see paragraph 12.14B).

Derecognition

12.14 A micro-entity shall derecognise a financial instrument within the scope of this section:

(a) when one or more of the conditions in paragraph 11.33 are met; or

(b) when no future economic benefits are expected from holding it or its disposal.

12.14A A micro-entity shall recognise the **gain** or loss on the derecognition in profit or loss when the item is derecognised. The micro-entity shall not classify such gains as **revenue**.

Onerous contracts

12.14B At each reporting date the micro-entity shall assess whether a financial instrument within the scope of this section constitutes an onerous contract. The present obligation arising from an onerous contract shall be recognised and measured in accordance with Section 21 *Provisions and Contingencies*.

12.15 to 12.25B [Not used]

Disclosures

12.26 A micro-entity applying this section shall make all of the disclosures required in Section 11 incorporating those disclosures relating to financial instruments that are within the scope of this section as well as those within the scope of Section 11. In addition, for financial instruments within the scope of this section, a micro-entity shall make the disclosures required by paragraphs 12.30 and 12.31.

12.27 to 12.29A [Not used]

12.30 A micro-entity shall disclose the total amount of any **contingent liability** not recognised in the **statement of financial position** in accordance with paragraph 8.8(a).

12.31 A micro-entity shall disclose the total amount of any financial commitments not included in the statement of financial position in accordance with paragraph 8.8(a).

Section 13
Inventories

Scope of this section

13.1 This section sets out the principles for recognising and measuring **inventories**.

13.2 This section applies to all inventories, except:

(a) work in progress arising under **construction contracts**, including directly related service contracts (see Section 23 *Revenue*); and

(b) [not used]

(c) **biological assets** related to **agricultural activity** and **agricultural produce** at the point of harvest (see Section 34 *Specialised Activities*).

13.3 [Not used]

Measurement of inventories

13.4 A **micro-entity** shall measure inventories at the lower of **cost** and estimated selling price less costs to complete and sell.

13.4A [Not used]

Cost of inventories

13.5 A micro-entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

13.5A Where inventories are acquired through a **non-exchange transaction**, their cost shall be measured at their **fair value** at the date of acquisition.

Costs of purchase

13.6 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the micro-entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

13.7 If payment is deferred beyond normal credit terms, the purchase price is the cash price available at the date of purchase. Any excess of the deferred payment amount over the cash price available at the date of purchase is recognised as interest and accounted for in accordance with paragraph 11.16A.

Costs of conversion

13.8 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as **depreciation** and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

13.8A Production overheads include the costs for obligations (recognised and measured in accordance with Section 21 *Provisions and Contingencies*) for dismantling, removing and restoring a site on which an item of **property, plant and equipment** is located that are incurred during the **reporting period** as a consequence of having used that item of property, plant and equipment to produce inventory during that period.

Allocation of production overheads

13.9 A micro-entity shall allocate fixed production overheads to the costs of conversion on the basis of the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an **expense** in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

13.10 [Not used]

Other costs included in inventories

13.11 A micro-entity shall include other costs in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

13.12 [Not used]

Costs excluded from inventories

13.13 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary during the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

Cost of inventories of a service provider

13.14 To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

Cost of agricultural produce harvested from biological assets

13.15 Section 34 requires that inventories comprising agricultural produce that a micro-entity has harvested from its biological assets should be measured on initial **recognition,** at the point of harvest, at the lower of cost and estimated selling price less costs to complete and sell. This becomes the cost of the inventories at that date for application of this section.

Techniques for measuring cost, such as standard costing, retail method and most recent purchase price

13.16 A micro-entity may use techniques such as the standard cost method, the retail method or most recent purchase price for measuring the cost of inventories if the result approximates cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions. The retail method measures cost by reducing the sales value of the inventory by the appropriate percentage gross margin.

Cost formulas

13.17 A micro-entity shall measure the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects by using specific identification of their individual costs.

13.18 A micro-entity shall measure the cost of inventories, other than those dealt with in paragraph 13.17, by using the first-in, first-out (FIFO) or weighted average cost formula. A micro-entity shall use the same cost formula for all inventories having a similar nature and use to the micro-entity. For inventories with a different nature or use, different cost formulas may be justified. The last-in, first-out method (LIFO) is not permitted by this [draft] FRS.

Impairment of inventories

13.19 Implicit in the requirement for a micro-entity to measure inventories at the lower of cost and estimated selling price less costs to complete, is a requirement that a micro-entity shall assess at the end of each reporting period whether any inventories are impaired, ie the **carrying amount** is not fully recoverable (eg because of damage, obsolescence or declining selling prices). If an item (or group of items) of inventory is impaired, the micro-entity shall recognise an **impairment loss**. When the circumstances that previously caused inventories to be impaired no longer exist or when there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances, the micro-entity shall reverse the amount of the impairment (ie the reversal is limited to the amount of the original impairment loss).

Recognition as an expense

13.20 When inventories are sold, the micro-entity shall recognise the carrying amount of those inventories as an expense in the period in which the related **revenue** is recognised.

13.20A [Not used]

13.21 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another **asset** in this way are accounted for subsequently in accordance with the section of this [draft] FRS relevant to that type of asset.

13.22 A micro-entity shall disclose the nature and form of any inventories that are pledged as security in accordance with paragraph 8.8(b).

Section 14
Investments in Associates

Scope of this section

14.1 This section applies to the accounting for investments in **associates** in the financial statements of a **micro-entity**.

14.2 to 14.3 [Not used]

Accounting treatment

14.4 A micro-entity shall refer to Section 11 *Basic Financial Instruments* which sets out the requirements for all investments in shares, including investments in associates.

14.5 to 14.15 [Not used]

Section 15
Investments in Joint Ventures

Scope of this section

15.1 This section applies to the accounting for investments in **joint ventures** that are jointly controlled operations and jointly controlled **assets**. A **micro-entity** shall refer to Section 11 *Basic Financial Instruments* which sets out the requirements for investments in **jointly controlled entities**.

Joint ventures defined

15.2 **Joint control** is the contractually agreed sharing of **control** over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the **venturers**).

15.3 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.

Jointly controlled operations

15.4 The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own **property, plant and equipment** and carries its own **inventories**. It also incurs its own **expenses** and **liabilities** and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides a means by which the **revenue** from the sale of the joint product and any expenses incurred in common are shared among the venturers.

15.5 In respect of its interests in jointly controlled operations, a venturer shall recognise in its financial statements:

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the **income** that it earns from the sale of goods or services by the joint venture.

Jointly controlled assets

15.6 Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture.

15.7 In respect of its interest in a jointly controlled asset, a venturer shall recognise in its financial statements:

(a) its share of the jointly controlled assets, classified according to the nature of the assets;

(b) any liabilities that it has incurred;

(c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses that it has incurred in respect of its interest in the joint venture.

Jointly controlled entities

15.8 A micro-entity shall refer to Section 11 which sets out the requirements for all investments in shares, including investments in jointly controlled entities.

15.9 to 15.21A [Not used]

Section 16
Investment Property

Scope of this section

16.1 This section applies to accounting for investments in land or buildings that meet the definition of **investment property**.

16.2 to 16.4 [Not used]

Measurement at initial recognition

16.5 A **micro-entity** shall measure investment property at its cost at initial **recognition**. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other **transaction costs**. If payment is deferred beyond normal credit terms, the purchase price is the cash price payable at the date of purchase. Any excess of the deferred payment amount over the cash price available at the date of purchase is recognised as interest and accounted in accordance with paragraph 11.16A. A micro-entity shall determine the cost of a self-constructed investment property in accordance with paragraphs 17.10 to 17.14.

16.6 [Not used]

Measurement after recognition

16.7 A micro-entity shall subsequently account for all investment property at cost less any accumulated **depreciation** less any accumulated **impairment losses** in accordance with Section 17 *Property, Plant and Equipment*.

16.8 to 16.11 [Not used]

Section 17
Property, Plant and Equipment

Scope of this section

17.1 This section applies to the accounting for **property**, **plant and equipment** and to **investment property**.

17.2 [Not used]

17.3 Property, plant and equipment does not include **biological assets** related to **agricultural activity** (see Section 34 *Specialised Activities*).

Recognition

17.4 A **micro-entity** shall recognise the cost of an item of property, plant and equipment as an **asset** if, and only if:

(a) it is **probable** that future economic benefits associated with the item will flow to the micro-entity; and

(b) the cost of the item can be measured reliably.

17.5 Spare parts and servicing equipment are usually carried as **inventory** and recognised in **profit or loss** as consumed. However, major spare parts and stand-by equipment are property, plant and equipment when a micro-entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are considered property, plant and equipment.

17.6 Parts of some items of property, plant and equipment may require replacement at regular intervals (eg the roof of a building). A micro-entity shall add to the **carrying amount** of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the micro-entity. The carrying amount of those parts that are replaced is derecognised in accordance with paragraphs 17.27 to 17.28.

17.7 A condition of continuing to operate an item of property, plant and equipment (eg a bus) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the **recognition** criteria are satisfied. Any remaining carrying amount of the cost of the previous major inspection (as distinct from physical parts) is derecognised. This is done regardless of whether the cost of the previous major inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

17.8 Land and buildings are separable assets, and a micro-entity shall account for them separately, even when they are acquired together.

Measurement at initial recognition

17.9 A micro-entity shall measure an item of property, plant and equipment at initial recognition at its cost.

Elements of cost

17.10 The cost of an item of property, plant and equipment comprises all of the following:

(a) Its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. These can include the costs of site preparation, initial delivery and handling, installation and assembly, and testing of functionality.

(c) The initial estimate of the costs, recognised and measured in accordance with Section 21 *Provisions and Contingencies,* of dismantling and removing the item and restoring the site on which it is located, the obligation for which a micro-entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

17.11 The following costs are not costs of an item of property, plant and equipment, and a micro-entity shall recognise them as an **expense** when they are incurred:

(a) costs of opening a new facility;

(b) costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(d) administration and other general overhead costs.

17.12 The **income** and related expenses of incidental operations during construction or development of an item of property, plant and equipment are recognised in profit or loss if those operations are not necessary to bring the item to its intended location and operating condition.

Measurement of cost

17.13 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the cost is the cash price available at the recognition date. Any excess of the deferred payment amount over the cash price available at the recognition date is recognised as interest and accounted for in accordance with paragraph 11.16A.

Exchanges of assets

17.14 An item of property, plant or equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. A micro-entity shall measure the cost of the acquired asset at **fair value** unless:

(a) the exchange transaction lacks commercial substance; or

(b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case, the asset's cost is measured at the carrying amount of the asset given up.

Measurement after initial recognition

17.15 A micro-entity shall measure all items of property, plant and equipment after initial recognition at cost less any accumulated **depreciation** and any accumulated

impairment losses. A micro-entity shall recognise the costs of day-to-day servicing of an item of property, plant and equipment in profit or loss in the period in which the costs are incurred.

17.15A to 17.15F [Not used]

Depreciation

17.16 If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, a micro-entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its **useful life**. Other assets shall be depreciated over their useful lives as a single asset. There are some exceptions, such as land which generally has an unlimited useful life and therefore is not usually depreciated.

17.17 The depreciation charge for each period shall be recognised in profit or loss unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset. For example, the depreciation of manufacturing property, plant and equipment is included in the costs of inventories (see Section 13 *Inventories*).

Depreciable amount and depreciation period

17.18 A micro-entity shall allocate the **depreciable amount** of an asset on a systematic basis over its useful life.

17.19 Factors may indicate that the **residual value** or useful life of an asset has changed since the most recent annual **reporting date**. If such indicators are present, a micro-entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life. The micro-entity shall account for the change in residual value, depreciation method or useful life as a change in an accounting estimate in accordance with paragraphs 10.15 to 10.17.

17.20 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

17.21 [Not used]

Depreciation method

17.22 A micro-entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset's future economic benefits. The possible depreciation methods include the straight-line method, the diminishing balance method and a method based on usage such as the units of production method.

17.23 If there is an indication that there has been a significant change since the last annual reporting date in the pattern by which a micro-entity expects to consume an asset's future economic benefits, the micro-entity shall review its present depreciation method and, if current expectations differ, change the depreciation method to reflect the new pattern. The micro-entity shall account for the change as a change in an accounting estimate in accordance with paragraphs 10.15 to 10.18.

Impairment

Recognition and measurement of impairment

17.24 At each reporting date, a micro-entity shall apply Section 27 *Impairment of Assets* to determine whether an item or group of items of property, plant and equipment is impaired and, if so, how to recognise and measure the impairment loss. That section explains when and how a micro-entity reviews the carrying amount of its assets, how it determines the **recoverable amount** of an asset, and when it recognises or reverses an impairment loss.

17.25 [Not used]

Property, plant and equipment held for sale

17.26 Paragraph 27.9(f) states that a plan to dispose of an asset before the previously expected date is an indicator of impairment that triggers the calculation of the asset's recoverable amount for the purpose of determining whether the asset is impaired.

Derecognition

17.27 A micro-entity shall derecognise an item of property, plant and equipment:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

17.28 A micro-entity shall recognise the **gain** or loss on the **derecognition** of an item of property, plant and equipment in profit or loss when the item is derecognised (unless Section 20 *Leases* requires otherwise on a sale and leaseback). The micro-entity shall not classify such gains as **revenue**.

17.29 to 17.31 [Not used]

17.32 A micro-entity shall disclose the following in accordance with paragraphs 8.8(a) and (b):

(a) the nature and form of any items of property, plant and equipment that are pledged as security; and

(b) the amount of contractual commitments not recognised in the **statement of financial position** for the acquisition of property, plant and equipment.

17.32A [Not used]

Section 18
Intangible Assets other than Goodwill

Scope of this section

18.1 This section applies to accounting for all **intangible assets** other than **goodwill** (see Section 19 *Business Combinations and Goodwill*) and intangible assets held by a **micro-entity** for sale in the ordinary course of business (see Section 13 *Inventories* and Section 23 *Revenue*).

18.1A to 18.3 [Not used]

Recognition

General principle for recognising intangible assets

18.4 A micro-entity shall recognise an intangible asset if, and only if:

(a) it is **probable** that the expected future economic benefits that are attributable to the asset will flow to the micro-entity; and

(b) the cost or value of the asset can be measured reliably; and

(c) the asset does not result from expenditure incurred internally on an intangible item.

18.5 A micro-entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the economic conditions that will exist over the **useful life** of the asset.

18.6 A micro-entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial **recognition**, giving greater weight to external evidence.

18.7 The probability recognition criterion in paragraph 18.4(a) is always considered satisfied for intangible assets that are separately acquired.

18.8 to 18.8B [Not used]

18.8C [Moved to 18.8E]

18.8D [Not used]

Internally generated intangible items

18.8E No intangible asset shall be recognised from expenditure incurred internally. Expenditure on both **research** and **development** activities shall be recognised as an **expense** when it is incurred.

As further examples, a micro-entity shall recognise expenditure on the following items as an expense and shall not recognise such expenditure as intangible assets:

(a) Internally generated brands, logos, publishing titles, customer lists and items similar in substance.

(b) Start-up activities (ie start-up costs), which include establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or **business** (ie pre-opening costs) and expenditure for starting new operations or launching new products or processes (ie pre-operating costs).

(c) Training activities.

(d) Advertising and promotional activities.

(e) Relocating or reorganising part or all of a micro-entity.

(f) Internally generated goodwill.

18.8F to 18.8K [Not used]

Initial measurement

18.9 A micro-entity shall measure an intangible asset initially at cost.

Separate acquisition

18.10 The cost of a separately acquired intangible asset comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

(b) any directly attributable cost of preparing the asset for its intended use.

18.10A to 18.16 [Not used]

Past expenses not to be recognised as an asset

18.17 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised at a later date as part of the cost of an asset.

Measurement after initial recognition

18.18 A micro-entity shall measure intangible assets after initial recognition at cost less any accumulated **amortisation** and any accumulated **impairment losses**. The requirements for amortisation are set out in paragraphs 18.19 to 18.24.

18.18A to 18.18H [Not used]

Amortisation over useful life

18.19 All intangible assets shall be considered to have a finite useful life. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the micro-entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the micro-entity without significant cost.

18.20 If, in exceptional cases, a micro-entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall not exceed 10 years.

Amortisation period and amortisation method

18.21 A micro-entity shall allocate the **depreciable amount** of an intangible asset on a systematic basis over its useful life. The amortisation charge for each period shall be recognised in **profit or loss**, unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset. For example, the amortisation of an intangible asset may be included in the costs of **inventories** or **property, plant and equipment**.

18.22 Amortisation begins when the intangible asset is available for use, ie when it is in the location and condition necessary for it to be usable in the manner intended by management. Amortisation ceases when the asset is derecognised. The micro-entity shall choose an amortisation method that reflects the pattern in which it expects to consume the asset's future economic benefits. If the micro-entity cannot determine that pattern reliably, it shall use the straight-line method.

Residual value

18.23 A micro-entity shall assume that the **residual value** of an intangible asset is zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an **active market** for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

Review of amortisation period and amortisation method

18.24 Factors may indicate that the residual value or useful life of an intangible asset has changed since the most recent annual **reporting date**. If such indicators are present, a micro-entity shall review its previous estimates and, if current expectations differ, amend the residual value, amortisation method or useful life. The micro-entity shall account for the change in residual value, amortisation method or useful life as a change in an accounting estimate in accordance with paragraphs 10.15 to 10.17.

Recoverability of the carrying amount—impairment losses

18.25 To determine whether an intangible asset is impaired, a micro-entity shall apply Section 27 *Impairment of Assets*. That section explains when and how a micro-entity reviews the **carrying amount** of its assets, how it determines the **recoverable amount** of an asset, and when it recognises or reverses an impairment loss.

Retirements and disposals

18.26 A micro-entity shall derecognise an intangible asset, and shall recognise a **gain** or loss in profit or loss:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

18.27 [Not used]

18.28 A micro-entity shall disclose the following in accordance with paragraph 8.8(a) and (b):

(a) and (b) [not used]

(c) the nature and form of any intangible assets that are pledged as security; and

(d) the amount of contractual commitments not recognised in the **statement of financial position** for the acquisition of intangible assets.

18.29 to 18.29A [Not used]

Section 19
Business Combinations and Goodwill

Accounting for a trade and asset acquisition

19.1A Where a **micro-entity** effects a **business combination** by acquiring the trade and **assets** of another **business**, it shall apply the following sections / paragraphs of **FRS 102**:

(a) the recognition and **measurement** requirements of Section 19 *Business Combinations and Goodwill* of FRS 102;

(b) the recognition and measurement requirements of paragraphs 18.8 and 18.11 of FRS 102 (if applicable); and

(c) any related transitional exemptions of Section 35 *Transition to this FRS* of FRS 102.

19.1B A micro-entity is not required to provide the disclosures associated with the above sections of FRS 102.

19.2 to 19.22 [Not used]

Goodwill arising on a trade and asset acquisition

19.23 Where a micro-entity has recognised **goodwill** acquired in a trade and asset acquisition (in accordance with paragraph 19.22 of FRS 102), the micro-entity shall measure that goodwill at cost less accumulated **amortisation** and accumulated **impairment losses**:

(a) A micro-entity shall follow the principles in paragraphs 18.19 to 18.24 of this [draft] FRS for amortisation of goodwill. Goodwill shall be considered to have a finite **useful life**, and shall be amortised on a systematic basis over its life. If, in exceptional cases, a micro-entity is unable to make a reliable estimate of the useful life of goodwill, the life shall not exceed 10 years.

(b) A micro-entity shall follow Section 27 *Impairment of Assets* of this [draft] FRS for recognising and measuring the impairment of goodwill.

19.24 to 19.33 [Not used]

Section 20
Leases

Scope of this section

20.1 This section covers accounting for all **leases** other than:

(a) [Not used]

(b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights (see Section 18 *Intangible Assets other than Goodwill*);

(c) **measurement** of property held by lessees that is accounted for as **investment property** and measurement of investment property provided by lessors under **operating leases** (see Section 16 *Investment Property*); and

(d) measurement of **biological assets** held by lessees under **finance leases** and biological assets provided by lessors under operating leases (see Section 34).

(e) [Not used]

(f) [Not used]

20.2 This section applies to agreements that transfer the right to use **assets** even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This section does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

20.3 Some arrangements do not take the legal form of a lease but convey rights to use assets in return for payments. Examples of such arrangements may include outsourcing arrangements, telecommunication contracts that provide rights to capacity and take-or-pay contracts.

20.3A Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement.

Classification of leases

20.4 A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

20.5 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

(a) the lease transfers ownership of the **asset** to the lessee by the end of the **lease term**;

(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the **fair value** at the date the option becomes exercisable for it to be reasonably certain, at the **inception of the lease**, that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the **present value** of the **minimum lease payments** amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

20.6 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) **gains** or losses from the fluctuation in the **residual value** of the leased asset accrue to the lessee (eg in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

(c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

20.7 The examples and indicators in paragraphs 20.5 and 20.6 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset is transferred to the lessee at the end of the lease for a variable payment equal to the asset's then fair value, or if there are **contingent rents**, as a result of which the lessee does not have substantially all risks and rewards incidental to ownership.

20.8 Lease classification is made at the inception of the lease and is not changed during the term of the lease unless the lessee and the lessor agree to change the provisions of the lease (other than simply by renewing the lease), in which case the lease classification shall be re-evaluated.

Financial statements of lessees: finance leases

Initial recognition

20.9 At the **commencement of the lease term**, a lessee shall recognise its rights of use and obligations under finance leases as assets and **liabilities** in its **statement of financial position** at amounts equal to the fair value of the leased asset or, if lower, the present value of the minimum lease payments, determined at the inception of the lease. Any initial direct costs of the lessee (incremental costs that are directly attributable to negotiating and arranging a lease) are added to the amount recognised as an asset.

20.10 The present value of the minimum lease payments shall be calculated using the **interest rate implicit in the lease**. If this cannot be determined, the **lessee's incremental borrowing rate** shall be used.

Subsequent measurement

20.11 A lessee shall apportion minimum lease payments between the finance charge and the reduction of the outstanding liability. The lessee shall allocate the finance charge to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. A lessee shall charge contingent rents as **expenses** in the periods in which they are incurred.

20.12 A lessee shall depreciate an asset leased under a finance lease in accordance with Section 17 *Property, Plant and Equipment*. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its **useful life**. A lessee shall also assess at each **reporting date** whether an asset leased under a finance lease is impaired (see Section 27 *Impairment of Assets*.

20.13 to 20.14 [Not used]

Financial statements of lessees: operating leases

Recognition and measurement

20.15 A lessee shall recognise lease payments under operating leases (excluding costs for services such as insurance and maintenance) as an expense over the lease term on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.

20.15A A lessee shall recognise the aggregate benefit of **lease incentives** as a reduction to the expense recognised in accordance with paragraph 20.15 over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset. Any costs incurred by the lessee (for example costs for termination of a pre-existing lease, relocation or leasehold improvements) shall be accounted for in accordance with the applicable section of this [draft] FRS.

20.15B Where an operating lease becomes an **onerous contract** a **micro-entity** shall also apply Section 21 *Provisions and Contingencies*.

20.16 A micro-entity shall disclose the total amount of any financial commitments not included in the statement of financial position arising from operating leases in accordance with paragraph 8.8(a).

Financial statements of lessors: finance leases

Initial recognition and measurement

20.17 A lessor shall recognise assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the **net investment in the lease**. The net investment in a lease is the lessor's **gross investment in the lease** discounted at the interest rate implicit in the lease. The gross investment in the lease is the aggregate of:

(a) the minimum lease payments receivable by the lessor under a finance lease; and

(b) any unguaranteed residual value accruing to the lessor.

20.18 For finance leases other than those involving manufacturer or dealer lessors, initial direct costs (costs that are incremental and directly attributable to negotiating and arranging a lease) are included in the initial measurement of the finance lease receivable and reduce the amount of **income** recognised over the lease term.

Subsequent measurement

20.19 The **recognition** of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income. If there is an indication that the estimated unguaranteed residual value used in computing the lessor's gross investment in the lease has changed significantly, the income allocation over the lease term is revised, and any reduction in respect of amounts accrued is recognised immediately in **profit or loss**.

Manufacturer or dealer lessors

20.20 Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

(a) profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and

(b) finance income over the lease term.

20.21 The sales **revenue** recognised at the commencement of the lease term by a manufacturer or dealer lessor is the fair value of the asset or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest. The cost of sale recognised at the commencement of the lease term is the cost, or **carrying amount** if different, of the leased asset less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the micro-entity's policy for outright sales.

20.22 If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.

20.23 [Not used]

Financial statements of lessors: operating leases

Recognition and measurement

20.24 A lessor shall present assets subject to operating leases in its statement of financial position according to the nature of the asset.

20.25 A lessor shall recognise lease income from operating leases (excluding amounts for services such as insurance and maintenance) in profit or loss on a straight-line basis over the lease term unless another systematic basis is representative of the time pattern of the lessee's benefit from the leased asset, even if the receipt of payments is not on that basis.

20.25A A lessor shall recognise the aggregate cost of lease incentives as a reduction to the income recognised in accordance with paragraph 20.25 over the lease term on a straight-line basis, unless another systematic basis is representative of the time pattern over which the lessor's benefit from the leased asset is diminished.

20.26 A lessor shall recognise as an expense, costs, including **depreciation**, incurred in earning the lease income. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.

20.27 A lessor shall add to the carrying amount of the leased asset any initial direct costs it incurs in negotiating and arranging an operating lease and shall recognise such costs as an expense over the lease term on the same basis as the lease income.

20.28 To determine whether a leased asset has become impaired, a lessor shall apply Section 27.

20.29 A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

20.30 to 20.31 [Not used]

Sale and leaseback transactions

20.32 A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease.

Sale and leaseback transaction results in a finance lease

20.33 If a sale and leaseback transaction results in a finance lease, the seller-lessee shall not recognise immediately, as income, any excess of sales proceeds over the carrying amount. Instead, the seller-lessee shall defer such excess and amortise it over the lease term.

Sale and leaseback transaction results in an operating lease

20.34 If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, the seller-lessee shall recognise any profit or loss immediately. If the sale price is below fair value, the seller-lessee shall recognise any profit or loss immediately unless the loss is compensated for by future lease payments at below market price. In that case the seller-lessee shall defer and amortise such loss in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the seller-lessee shall defer the excess over fair value and amortise it over the period for which the asset is expected to be used.

20.35 A micro-entity shall disclose the total amount of any financial commitments arising from a sale and lease back transaction in accordance with paragraph 8.8(a).

Section 21
Provisions and Contingencies

Scope of this section

21.1 This section applies to all **provisions**, **contingent liabilities** and **contingent assets** except those provisions covered by other sections of this [draft] FRS. Where those other sections contain no specific requirements to deal with contracts that have become onerous, this section applies to those contracts.

21.1A [Not used]

21.1B This section does not apply to **financial instruments** that are within the scope of Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* unless the contracts are **onerous contracts** or **financial guarantee contracts**.

21.2 The requirements in this section do not apply to executory contracts unless they are onerous contracts. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

21.3 The word 'provision' is sometimes used in the context of such items as **depreciation**, impairment of **assets**, and uncollectible receivables. Those are adjustments of the **carrying amounts** of assets, rather than **recognition** of **liabilities**, and therefore are not covered by this section.

Initial recognition

21.4 A **micro-entity** shall recognise a provision only when:

(a) the micro-entity has an obligation at the **reporting date** as a result of a past event;

(b) it is **probable** (ie more likely than not) that the micro-entity will be required to transfer economic benefits in settlement; and

(c) the amount of the obligation can be estimated reliably.

21.5 The micro-entity shall recognise the provision as a liability in the **statement of financial position** and shall recognise the amount of the provision as an **expense**, unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset such as **inventories** or **property, plant and equipment**.

21.6 The condition in paragraph 21.4(a) means that the micro-entity has no realistic alternative to settling the obligation. This can happen when the micro-entity has a legal obligation that can be enforced by law or when the micro-entity has a **constructive obligation** because the past event (which may be an action of the micro-entity) has created valid expectations in other parties that the micro-entity will discharge the obligation. Obligations that will arise from the micro-entity's future actions (ie the future conduct of its business) do not satisfy the condition in paragraph 21.4(a), no matter how likely they are to occur and even if they are contractual. To illustrate, because of commercial pressures or legal requirements, a micro-entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a particular type of factory). Because the micro-entity can avoid the future expenditure by its future actions, for example by changing its method of operation or selling the factory, it has no present obligation for that future expenditure and no provision is recognised.

Initial measurement

21.7 A micro-entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount a micro-entity would rationally pay to settle the obligation at the end of the **reporting period** or to transfer it to a third party at that time.

(a) When the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 per cent or 90 per cent. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

(b) When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation. However, even in such a case, the micro-entity considers other possible outcomes. When other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

When the effect of the time value of money is **material**, the amount of a provision shall be the **present value** of the amount expected to be required to settle the obligation. The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and risks specific to the liability. The risks specific to the liability shall be reflected either in the discount rate or in the estimation of the amounts required to settle the obligation, but not both.

21.8 A micro-entity shall exclude **gains** from the expected disposal of assets from the **measurement** of a provision.

21.9 When some or all of the amount required to settle a provision may be reimbursed by another party (eg through an insurance claim), the micro-entity shall recognise the reimbursement as a separate asset only when it is virtually certain that the micro-entity will receive the reimbursement on settlement of the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision. The reimbursement receivable shall be presented in the statement of financial position as an asset and shall not be offset against the provision. In the **income statement** the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

Subsequent measurement

21.10 A micro-entity shall charge against a provision only those expenditures for which the provision was originally recognised.

21.11 A micro-entity shall review provisions at each reporting date and adjust them to reflect the current best estimate of the amount that would be required to settle the obligation at that reporting date. Any adjustments to the amounts previously recognised shall be recognised in **profit or loss** unless the provision was originally recognised as part of the cost of an asset (see paragraph 21.5). When a provision is measured at the present value of the amount expected to be required to settle the obligation, the unwinding of the discount shall be recognised as interest expense in profit or loss in the period it arises.

Onerous contracts

21.11A If a micro-entity has an onerous contract, the present obligation under the contract shall be recognised and measured as a provision (see Example 2 of the Appendix to this section).

Future operating losses

21.11B Provisions shall not be recognised for future operating losses (see Example 1 of the Appendix to this section).

Restructuring

21.11C A **restructuring** gives rise to a constructive obligation only when a micro-entity:

(a) has a detailed formal plan for the restructuring identifying at least:

  (i) the **business** or part of a business concerned;

  (ii) the principal locations affected;

  (iii) the location, function, and approximate number of employees who will be compensated for terminating their services;

  (iv) the expenditures that will be undertaken; and

  (v) when the plan will be implemented; and

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

21.11D A micro-entity recognises a provision for restructuring costs only when it has a legal or constructive obligation at the reporting date to carry out the restructuring.

Contingent liabilities

21.12 A contingent liability is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 21.4. A micro-entity shall not recognise a contingent liability as a liability, except for provisions for contingent liabilities of an acquiree in a trade and asset acquisition (see Section 19 *Business Combinations and Goodwill*). Disclosure of a contingent liability is required by paragraph 21.15 unless the possibility of an outflow of resources is remote. When a micro-entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.

Contingent assets

21.13 A micro-entity shall not recognise a contingent asset as an asset. However, when the flow of future economic benefits to the micro-entity is virtually certain, then the related asset is not a contingent asset, and its **recognition** is appropriate.

21.14 [Not used]

Disclosures about contingent liabilities

21.15 A micro-entity shall disclose the total amount of any contingent liabilities not recognised in the statement of financial position in accordance with paragraph 8.8(a).

Disclosures about contingent assets

21.16 A micro-entity shall disclose the total amount of any contingent assets not recognised in the statement of financial position in accordance with paragraph 8.8(a).

21.17 to 21.17A [Not used]

Appendix to Section 21

Examples on recognising and measuring provisions

This appendix accompanies, but is not part of, Section 21. It provides guidance for applying the requirements of Section 21 in recognising and measuring provisions.

All of the micro-entities in the examples in this appendix have 31 December as their reporting date. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets; this aspect is not dealt with in the examples. References to 'best estimate' are to the present value amount, when the effect of the time value of money is material.

Example 1 Future operating losses

21A.1 A micro-entity determines that it is probable that a segment of its operations will incur future operating losses for several years.

Present obligation as a result of a past obligating event: There is no past event that obliges the micro-entity to pay out resources.

Conclusion: The micro-entity does not recognise a provision for future operating losses. Expected future losses do not meet the definition of a liability. The expectation of future operating losses may be an indicator that one or more assets are impaired (see Section 27 *Impairment of Assets* of this [draft] FRS).

Example 2 Onerous contracts

21A.2 An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. For example, a micro-entity may be contractually required under an operating lease to make payments to lease an asset for which it no longer has any use.

Present obligation as a result of a past obligating event: The micro-entity is contractually required to pay out resources for which it will not receive commensurate benefits.

Conclusion: If a micro-entity has a contract that is onerous, the micro-entity recognises and measures the present obligation under the contract as a provision.

Example 3 Restructurings

21A.3 [Moved to paragraph 21.11C]

Example 4 Warranties

21A.4 A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On the basis of experience, it is probable (ie more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event: The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement: Probable for the warranties as a whole.

Conclusion: The micro-entity recognises a provision for the best estimate of the costs of making good under the warranty products sold before the reporting date.

Illustration of calculations:

In 20X0, goods are sold for CU1,000,000. Experience indicates that 90 per cent of products sold require no warranty repairs; 6 per cent of products sold require minor repairs costing 30 per cent of the sale price; and 4 per cent of products sold require major repairs or replacement costing 70 per cent of sale price. Therefore estimated warranty costs are:

CU1,000,000 × 90% × 0 =	CU0
CU1,000,000 × 6% × 30% =	CU18,000
CU1,000,000 × 4% × 70% =	CU28,000
Total	CU46,000

The expenditures for warranty repairs and replacements for products sold in 20X0 are expected to be made 60 per cent in 20X1, 30 per cent in 20X2, and 10 per cent in 20X3, in each case at the end of the period. Because the estimated cash flows already reflect the probabilities of the cash outflows, and assuming there are no other risks or uncertainties that must be reflected, to determine the present value of those cash flows the micro-entity uses a 'risk-free' discount rate based on government bonds with the same term as the expected cash outflows (6 per cent for one-year bonds and 7 per cent for two-year and three-year bonds). Calculation of the present value, at the end of 20X0, of the estimated cash flows related to the warranties for products sold in 20X0 is as follows:

Year		**Expected cash payments (CU)**	**Discount rate**	**Discount factor**	**Present value (CU)**
1	60% × CU46,000	27,600	6%	0.9434 (at 6% for 1 year)	26,038
2	30% × CU46,000	13,800	7%	0.8734 (at 7% for 2 years)	12,053
3	10% × CU46,000	4,600	7%	0.8163 (at 7% for 3 years)	3,755
Total					41,846

The micro-entity will recognise a warranty obligation of CU41,846 at the end of 20X0 for products sold in 20X0.

Example 5 Refunds policy

21A.5 A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event: The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement: Probable that a proportion of goods will be returned for refund.

Conclusion: The micro-entity recognises a provision for the best estimate of the amount required to settle the refunds.

Example 6 Closure of a division: no implementation before end of reporting period

21A.6 On 12 December 20X0 the board of a micro-entity decided to close down a division. Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation as a result of a past obligating event: There has been no obligating event, and so there is no obligation.

Conclusion: The micro-entity does not recognise a provision.

Example 7 Closure of a division: communication and implementation before end of reporting period

21A.7 On 12 December 20X0 the board of a micro-entity decided to close a division making a particular product. On 20 December 20X0 a detailed plan for closing the division was agreed by the board, letters were sent to customers warning them to seek an alternative source of supply, and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event: The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: The micro-entity recognises a provision at 31 December 20X0 for the best estimate of the costs that would be incurred to close the division at the reporting date.

Example 8 Staff retraining as a result of changes in the income tax system

21A.8 The government introduces changes to the income tax system. As a result of those changes, a micro-entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with tax regulations. At the end of the reporting period, no retraining of staff has taken place.

Present obligation as a result of a past obligating event: The tax law change does not impose an obligation on a micro-entity to do any retraining. An obligating event for recognising a provision (the retraining itself) has not taken place.

Conclusion: The micro-entity does not recognise a provision.

Example 9 A court case

21A.9 A customer has sued Micro-entity X, seeking damages for injury the customer allegedly sustained from using a product sold by Micro-entity X. Micro-entity X disputes liability on grounds that the customer did not follow directions in using the product. Up to the date the board authorised the financial statements for the year to 31 December 20X1 for issue, the micro-entity's lawyers advise that it is probable that the micro-entity will not be found liable. However, when the micro-entity prepares the financial statements for the year to 31 December 20X2, its lawyers advise that, owing to developments in the case, it is now probable that the micro-entity will be found liable.

(a) At 31 December 20X1

Present obligation as a result of a past obligating event: On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion: No provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At 31 December 20X2

Present obligation as a result of a past obligating event: On the basis of the evidence available, there is a present obligation. The obligating event is the sale of the product to the customer.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: A provision is recognised at the best estimate of the amount to settle the obligation at 31 December 20X2, and the expense is recognised in profit or loss. It is not a correction of an error in 20X1 because, on the basis of the evidence available when the 20X1 financial statements were approved, a provision should not have been recognised at that time.

Section 22
Liabilities and Equity

Scope of this section

22.1 This section establishes principles for classifying **financial instruments** as either **liabilities** or **equity** and deals with the accounting for **compound financial instruments**, such as convertible debt. It also addresses the issue of equity instruments, distributions to individuals or other parties acting in their capacity as investors in equity instruments (ie in their capacity as **owners**) and the accounting for purchases of own equity.

22.2 This section shall be applied to all types of financial instruments except:

(a) Investments in **subsidiaries**, **associates** and **joint ventures** that are accounted for in accordance with Section 11 *Basic Financial Instruments.*

(b) Employers' rights and obligations under employee benefit plans to which Section 28 *Employee Benefits* applies.

(c) [Not used]

(d) Financial instruments, contracts and obligations under **share-based payment transactions** to which Section 26 applies, except that paragraphs 22.3 to 22.5 shall be applied to **treasury shares** issued, purchased, sold, transferred or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.

(e) to (f) [Not used]

(g) **Financial guarantee contracts** (see Section 21 *Provisions and Contingencies*).

Classification of an instrument as liability or equity

22.3 Equity is the residual interest in the **assets** of a **micro-entity** after deducting all its liabilities. Equity includes investments by the owners of the micro-entity, plus additions to those investments earned through profitable operations and retained for use in the micro-entity's operations, minus reductions to owners' investments as a result of unprofitable operations and distributions to owners.

22.3A A financial instrument where the issuer can be required to settle the instrument in cash or by delivery of another **financial asset** (or otherwise to settle it in such a way that it would be a **financial liability**) only in the event of the liquidation of the issuer is classified as equity.

22.4 A financial instrument where the issuer does not have the unconditional right to avoid settling in cash or by delivery of another financial asset (or otherwise to settle it in such a way that it would be a financial liability), other than for the reason described in paragraph 22.3A is a financial liability of the issuer.

22.5 The following are examples of instruments that are classified as liabilities:

(a) An instrument is classified as a liability if the distribution of net assets on liquidation is subject to a maximum amount (a ceiling). For example, if on liquidation the holders of the instrument receive a pro rata share of the net assets, but this amount is limited to a ceiling and the excess net assets are distributed to a charity organisation or the government, the instrument is not classified as equity.

(b) [Not used]

(c) An instrument is classified as a liability if it obliges the micro-entity to make payments to the holder before liquidation, such as a mandatory dividend.

(d) [Not used]

(e) A preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.

22.6 [Not used]

Original issue of shares or other equity instruments

22.7 A micro-entity shall recognise the issue of shares or other equity instruments as equity when it issues those instruments and another party is obliged to provide cash or other resources to the micro-entity in exchange for the instruments.

(a) [Not used]

(b) If the micro-entity receives the cash or other resources before the equity instruments are issued, and the micro-entity cannot be required to repay the cash or other resources received, the micro-entity shall recognise the corresponding increase in equity to the extent of consideration received.

(c) To the extent that the equity instruments have been subscribed for but not issued (or called up), and the micro-entity has not yet received the cash or other resources, the micro-entity shall not recognise an increase in equity.

22.8 A micro-entity shall measure the equity instruments at the **fair value** of the cash or other resources received or receivable, net of direct costs of issuing the equity instruments.

22.9 A micro-entity shall account for the **transaction costs** of an equity transaction as a deduction from equity, net of any related **income tax** benefit.

22.10 [Not used]

Exercise of options, rights and warrants

22.11 A micro-entity shall apply the principles in paragraphs 22.7 to 22.9 to equity issued by means of exercise of options, rights, warrants and similar equity instruments.

22.12 [Not used]

Convertible debt

22.13 On issuing convertible debt, a micro-entity shall allocate the proceeds between the liability component and the equity component of the instrument. To make the allocation, the micro-entity shall first determine the amount of the liability component as the fair value of a similar liability that does not have a conversion feature or similar associated equity component. The micro-entity shall allocate the residual amount as the equity component. Transaction costs shall be allocated between the debt component and the equity component on the basis of their relative fair values.

22.14 The micro-entity shall not revise the allocation in a subsequent period.

22.15 In periods after the instruments were issued, the micro-entity shall account for the liability component as a financial instrument in accordance with Section 11. The example shown in the Appendix to Section 22 *Liabilities and Equity* of **FRS 102** illustrates the accounting for an issuer of convertible debt.

Treasury shares

22.16 Treasury shares are the equity instruments of a micro-entity that have been issued and subsequently reacquired by the micro-entity. A micro-entity shall deduct from equity the fair value of the consideration given for the treasury shares. The micro-entity shall not recognise a **gain** or loss in **profit or loss** on the purchase, sale, transfer or cancellation of treasury shares.

Distributions to owners

22.17 A micro-entity shall reduce equity for the amount of distributions to its owners (holders of its equity instruments).

22.18 to 22.19 [Not used]

Section 23
Revenue

Scope of this section

23.1 This section shall be applied in accounting for **revenue** arising from the following transactions and events:

(a) the sale of goods (whether produced by the **micro-entity** for the purpose of sale or purchased for resale);

(b) the rendering of services;

(c) **construction contracts** in which the micro-entity is the contractor; and

(d) the use by others of micro-entity **assets** yielding interest, royalties or dividends.

23.2 Revenue or other **income** arising from **lease** agreements is dealt with in Section 20 *Leases*.

23.2A [Not used]

Measurement of revenue

23.3 A micro-entity shall measure revenue at the amount receivable, taking into account any trade discounts, prompt settlement discounts and volume rebates allowed by the micro-entity.

23.4 A micro-entity shall include in revenue only the gross inflows of economic benefits received and receivable by the micro-entity on its own account. A micro-entity shall exclude from revenue all amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes. In an agency relationship, a micro-entity (the **agent**) shall include in revenue only the amount of its commission. The amounts collected on behalf of the **principal** are not revenue of the micro-entity.

Deferred payment

23.5 If payment is deferred beyond normal credit terms, the amount of revenue recognised is equal to the cash price available on the transaction date. Any excess of the deferred payment amount over the cash price available on the transaction date is recognised as interest and accounted for in accordance with paragraph 11.16A.

Exchanges of goods or services

23.6 A micro-entity shall not recognise revenue:

(a) when goods or services are exchanged for goods or services that are of a similar nature and value; or

(b) when goods or services are exchanged for dissimilar goods or services but the transaction lacks commercial substance.

23.7 A micro-entity shall recognise revenue when goods are sold or services are exchanged for dissimilar goods or services in a transaction that has commercial substance. In that case, the micro-entity shall measure the transaction:

(a) at the **fair value** of the goods or services received, adjusted by the amount of any cash transferred;

(b) if the amount under (a) cannot be measured reliably, then at the fair value of the goods or services given up adjusted by the amount of any cash transferred; or

(c) if the fair value of neither the goods or services received nor the goods or services given up can be measured reliably, then at the **carrying amount** of the goods or services given up adjusted by the amount of any cash transferred.

Identification of the revenue transaction

23.8 A micro-entity shall apply the **recognition** criteria to the separately identifiable components of a single transaction when necessary to reflect the substance of the transaction. For example, a micro-entity applies the recognition criteria to the separately identifiable components of a single transaction when the selling price of a product includes an identifiable amount for subsequent servicing. Conversely, a micro-entity applies the recognition criteria to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

23.9 [Not used]

Sale of goods

23.10 A micro-entity shall recognise revenue from the sale of goods when all the following conditions are satisfied:

(a) the micro-entity has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) the micro-entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

(c) the amount of revenue can be measured reliably;

(d) it is **probable** that the economic benefits associated with the transaction will flow to the micro-entity; and

(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

23.11 The assessment of when a micro-entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a time different from the transfer of legal title or the passing of possession.

23.12 A micro-entity does not recognise revenue if it retains significant risks and rewards of ownership. Examples of situations in which the micro-entity may retain the significant risks and rewards of ownership are:

(a) when the micro-entity retains an obligation for unsatisfactory performance not covered by normal warranties;

(b) when the receipt of the revenue from a particular sale is contingent on the buyer selling the goods;

(c) when the goods are shipped subject to installation and the installation is a significant part of the contract that has not yet been completed; and

(d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract, or at the buyer's sole discretion without any reason, and the micro-entity is uncertain about the probability of return.

23.13 [Not used]

Rendering of services

23.14 When the outcome of a transaction involving the rendering of services can be estimated reliably, a micro-entity shall recognise revenue associated with the transaction by reference to the stage of completion of the transaction at the end of the **reporting period** (sometimes referred to as the percentage of completion method). The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

(a) the amount of revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the micro-entity;

(c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and

(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Paragraphs 23.21 to 23.27 provide guidance for applying the percentage of completion method.

23.15 When services are performed by an indeterminate number of acts over a specified period of time, a micro-entity recognises revenue on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other act, the micro-entity postpones recognition of revenue until the significant act is executed.

23.16 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, a micro-entity shall recognise revenue only to the extent of the **expenses** recognised that are recoverable.

Construction contracts

23.17 When the outcome of a construction contract can be estimated reliably, a micro-entity shall recognise contract revenue and contract costs associated with the construction contract as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period (often referred to as the percentage of completion method). Reliable estimation of the outcome requires reliable estimates of the stage of completion, future costs and collectability of billings. Paragraphs 23.21 to 23.27 provide guidance for applying the percentage of completion method.

23.18 The requirements of this section are usually applied separately to each construction contract. However, in some circumstances, it is necessary to apply this section to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.

23.19 to 23.20 [Not used]

Percentage of completion method

23.21 This method is used to recognise revenue from rendering services (see paragraphs 23.14 to 23.16) and from construction contracts (see paragraphs 23.17 to 23.20). A micro-entity shall review and, when necessary, revise the estimates of revenue and costs as the service transaction or construction contract progresses.

23.22 A micro-entity shall determine the stage of completion of a transaction or contract using the method that measures most reliably the work performed. Possible methods include:

(a) the proportion that costs incurred for work performed to date bear to the estimated total costs. Costs incurred for work performed to date do not include costs relating to future activity, such as for materials or prepayments;

(b) surveys of work performed; and

(c) completion of a physical proportion of the contract work or the completion of a proportion of the service contract.

Progress payments and advances received from customers often do not reflect the work performed.

23.23 A micro-entity shall recognise costs that relate to future activity on the transaction or contract, such as for materials or prepayments, as an asset if it is probable that the costs will be recovered.

23.24 A micro-entity shall recognise as an expense immediately any costs whose recovery is not probable.

23.25 When the outcome of a construction contract cannot be estimated reliably:

(a) a micro-entity shall recognise revenue only to the extent of contract costs incurred that it is probable will be recoverable; and

(b) the micro-entity shall recognise contract costs as an expense in the period in which they are incurred.

23.26 When it is probable that total contract costs will exceed total contract revenue on a construction contract, the expected loss shall be recognised as an expense immediately, with a corresponding **provision** for an **onerous contract** (see Section 21 *Provisions and Contingencies*).

23.27 If the collectability of an amount already recognised as contract revenue is no longer probable, the micro-entity shall recognise the uncollectible amount as an expense rather than as an adjustment of the amount of contract revenue.

Interest, royalties and dividends

23.28 A micro-entity shall recognise revenue arising from the use by others of micro-entity assets yielding interest, royalties and dividends on the bases set out in paragraph 23.29 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the micro-entity; and

(b) the amount of the revenue can be measured reliably.

23.29 A micro-entity shall recognise revenue on the following bases:

(a) Interest income shall be recognised in accordance with Section 11 *Basic Financial Instruments*.

(b) Royalties shall be recognised on an **accrual basis** in accordance with the substance of the relevant agreement.

(c) Dividends shall be recognised when the shareholder's right to receive payment is established.

23.30 to 23.32 [Not used]

Appendix to Section 23

Examples of revenue recognition under the principles in Section 23

This appendix accompanies, but is not part of, Section 23. It provides guidance for applying the requirements of Section 23 in recognising revenue.

23A.1 The following examples focus on particular aspects of a transaction and are not a comprehensive discussion of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably, it is probable that the economic benefits will flow to the micro-entity and the costs incurred or to be incurred can be measured reliably.

Sale of goods

23A.2 The law in different countries may cause the recognition criteria in Section 23 to be met at different times. In particular, the law may determine the point in time at which the micro-entity transfers the significant risks and rewards of ownership. Therefore, the examples in this appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

Example 1 'Bill and hold' sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing

23A.3 The seller recognises revenue when the buyer takes title, provided:

(a) it is probable that delivery will be made;

(b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;

(c) the buyer specifically acknowledges the deferred delivery instructions; and

(d) the usual payment terms apply.

Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

Example 2 Goods shipped subject to conditions: installation and inspection

23A.4 The seller normally recognises revenue when the buyer accepts delivery, and installation and inspection are complete. However, revenue is recognised immediately upon the buyer's acceptance of delivery when:

(a) the installation process is simple, for example the installation of a factory-tested television receiver that requires only unpacking and connection of power and antennae; or

(b) the inspection is performed only for the purposes of final determination of contract prices, for example, shipments of iron ore, sugar or soya beans.

Example 3 Goods shipped subject to conditions: on approval when the buyer has negotiated a limited right of return

23A.5 If there is uncertainty about the possibility of return, the seller recognises revenue when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

Example 4 Goods shipped subject to conditions: consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller)

23A.6 The shipper recognises revenue when the goods are sold by the recipient to a third party.

Example 5 Goods shipped subject to conditions: cash on delivery sales

23A.7 The seller recognises revenue when delivery is made and cash is received by the seller or its agent.

Example 6 Layaway sales under which the goods are delivered only when the buyer makes the final payment in a series of instalments

23A.8 The seller recognises revenue from such sales when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognised when a significant deposit is received, provided the goods are on hand, identified and ready for delivery to the buyer.

Example 7 Orders when payment (or partial payment) is received in advance of delivery for goods not currently held in inventory, for example, the goods are still to be manufactured or will be delivered direct to the buyer from a third party

23A.9 The seller recognises revenue when the goods are delivered to the buyer.

Example 8 Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods

23A.10 For a sale and repurchase agreement on an asset other than a financial asset, the seller must analyse the terms of the agreement to ascertain whether, in substance, the risks and rewards of ownership have been transferred to the buyer. If they have been transferred, the seller recognises revenue. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, the derecognition provisions of Section 11 apply.

Example 9 Sales to intermediate parties, such as distributors, dealers or others for resale

23A.11 The seller generally recognises revenue from such sales when the risks and rewards of ownership have been transferred. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

Example 10 Subscriptions to publications and similar items

23A.12 When the items involved are of similar value in each time period, the seller recognises revenue on a straight-line basis over the period in which the items are dispatched. When the items vary in value from period to period, the seller recognises revenue on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

Example 11 Instalment sales, under which the consideration is receivable in instalments

23A.13 The seller recognises revenue based on the cash price a customer would pay at the date of sale. If the total amount paid through instalments is greater than the cash price payable at the date of sale, any excess is recognised as interest and accounted for in accordance with paragraph 11.16A.

Example 12 Agreements for the construction of real estate

23A.14 A micro-entity that undertakes the construction of real estate, directly or through subcontractors, and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement using the percentage of completion method, only if:

(a) the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not); or

(b) the buyer acquires and supplies construction materials and the micro-entity provides only construction services.

23A.15 If the micro-entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver real estate to the buyer, the agreement shall be accounted for as the sale of goods. In this case, the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Rather, the transfer occurs only on delivery of the completed real estate to the buyer.

Example 13 Sale with customer loyalty award

23A.16 A micro-entity sells product A for CU100. Purchasers of product A get an award credit enabling them to buy product B for CU10. The normal selling price of product B is CU18. The micro-entity estimates that 40 per cent of the purchasers of product A will use their award to buy product B at CU10. The normal selling price of product A, after taking into account discounts that are usually offered but that are not available during this promotion, is CU95.

23A.17 The fair value of the award credit is 40 per cent × [CU18 – CU10] = CU3.20. The micro-entity allocates the total revenue of CU100 between product A and the award credit by reference to their relative fair values of CU95 and CU3.20 respectively. Therefore:

(a) Revenue for product A is CU100 × [CU95 / (CU95 + CU3.20)] = CU96.74

(b) Revenue for product B is CU100 × [CU3.20 / (CU95 + CU3.20)] = CU3.26

Rendering of services

Example 14 Installation fees

23A.18 The seller recognises installation fees as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.

Example 15 Servicing fees included in the price of the product

23A.19 When the selling price of a product includes an identifiable amount for subsequent servicing (eg after sales support and product enhancement on the sale of software), the seller defers that amount and recognises it as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

Example 16 Advertising commissions

23A.20 Media commissions are recognised when the related advertisement or commercial appears before the public. Production commissions are recognised by reference to the stage of completion of the project.

23A.21 and 23A.21A [Not used]

Example 18 Admission fees

23A.22 The seller recognises revenue from artistic performances, banquets and other special events when the event takes place. When a subscription to a number of events is sold, the seller allocates the fee to each event on a basis that reflects the extent to which services are performed at each event.

Example 19 Tuition fees

23A.23 The seller recognises revenue over the period of instruction.

Example 20 Initiation, entrance and membership fees

23A.24 Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognised as revenue when no significant uncertainty about its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

Franchise fees

23A.25 Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognised as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate.

Example 21 Franchise fees: Supplies of equipment and other tangible assets

23A.26 The franchisor recognises the fair value of the assets sold as revenue when the items are delivered or title passes.

Example 22 Franchise fees: Supplies of initial and subsequent services

23A.27 The franchisor recognises fees for the provision of continuing services, whether part of the initial fee or a separate fee, as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognised as revenue as the services are rendered.

23A.28 The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of the initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognised over the period the goods are likely to be sold to the franchisee. The balance of an initial fee is recognised as revenue when performance of all the initial services and other obligations required of the franchisor (such as assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

23A.29 The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognised as revenue in proportion to the number of outlets for which the initial services have been substantially completed.

23A.30 If the initial fee is collectible over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognised as cash instalments are received.

Example 23 Franchise fees: Continuing franchise fees

23A.31 Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognised as revenue as the services are provided or the rights used.

Example 24 Franchise fees: Agency transactions

23A.32 Transactions may take place between the franchisor and the franchisee that, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

Example 25 Fees from the development of customised software

23A.33 The software developer recognises fees from the development of customised software as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

Interest, royalties and dividends

Example 26 Licence fees and royalties

23A.34 The licensor recognises fees and royalties paid for the use of a micro-entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films) in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use specified technology for a specified period of time.

23A.35 An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations after delivery. Another example is the granting of rights to exhibit a motion picture film in markets in which the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.

23A.36 In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

Section 24
Government Grants

Scope of this section

24.1 This section specifies the accounting for all **government grants**.

24.2 Government grants exclude those forms of government assistance that cannot reasonably have a value placed upon them and transactions with government that cannot be distinguished from the normal trading transactions of the **micro-entity**.

24.3 [Not used]

Recognition and measurement

24.3A Government grants, including non-monetary grants, shall not be recognised until there is reasonable assurance that:

(a) the micro-entity will comply with the conditions attaching to them; and

(b) the grants will be received.

24.4 [Not used]

24.5 A micro-entity shall measure grants at the **fair value** of the **asset** received or receivable.

24.5A Where a grant becomes repayable it shall be recognised as a **liability** when the repayment meets the definition of a liability.

24.5B A micro-entity shall recognise grants as follows:

(a) A grant that does not impose specified future **performance-related conditions** on the recipient is recognised in **income** when the grant proceeds are received or receivable.

(b) A grant that imposes specified future performance-related conditions on the recipient is recognised in income only when the performance-related conditions are met.

(c) Grants received before the **revenue** recognition criteria are satisfied are recognised as a liability.

24.5C to 24.7 [Not used]

Section 25
Borrowing Costs

Scope of this section

25.1 This section specifies the accounting for **borrowing costs**. Borrowing costs include:

(a) interest expense recognised in accordance with Section 11 *Basic Financial Instruments*;

(b) finance charges in respect of **finance leases** recognised in accordance with Section 20 *Leases*; and

(c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Recognition

25.2 A **micro-entity** shall recognise all borrowing costs as an **expense** in **profit or loss** in the period in which they are incurred.

25.2A to 25.3A [Not used]

Section 26
Share-based Payment

Scope of this section

26.1 This section specifies the accounting for all **share-based payment transactions** including:

(a) **equity-settled share-based payment transactions**;

(b) **cash-settled share-based payment transactions**; and

(c) transactions in which the **micro-entity** receives or acquires goods or services and the terms of the arrangement provide either the micro-entity or the supplier of those goods or services with a choice of whether the micro-entity settles the transaction in cash (or other **assets**) or by issuing equity instruments.

26.1A to 26.2 [Not used]

Recognition

26.2A A micro-entity is not required to account for equity-settled share-based payment transactions until shares are issued, at which point the micro-entity shall apply the requirements of Section 22 *Liabilities and Equity*.

26.3 A micro-entity shall recognise the goods or services received or acquired in a cash-settled share-based payment transaction when it obtains the goods or as the services are received, and shall recognise a corresponding **provision** in accordance with Section 21 *Provisions and Contingencies*.

26.4 When the goods or services received or acquired in a share-based payment transaction do not qualify for **recognition** as assets, the micro-entity shall recognise them as **expenses**.

Recognition when there are vesting conditions

26.5 If the cash-settled share-based payments granted to employees **vest** immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those cash-settled share-based payments. In the absence of evidence to the contrary, the micro-entity shall presume that services rendered by the employee as consideration for the share-based payments have been received. In this case, on **grant date** the micro-entity shall recognise the services received in full, with a corresponding provision.

26.6 If the cash-settled share-based payments do not vest until the employee completes a specified period of service, the micro-entity shall presume that the services to be rendered by the employee as consideration for those cash-settled share-based payments will be received in the future, during the vesting period. The micro-entity shall account for those services as they are rendered by the employee during the vesting period, with a corresponding increase in the provision.

26.7 to 26.14 [Not used]

Share-based payment transactions with cash alternatives

26.15 Some share-based payment transactions give either the micro-entity or the employee a choice of settling the transaction in cash (or other assets) or by transfer of equity instruments. In such a case, the micro-entity shall account for the transaction as a cash-settled share-based payment transaction unless either:

(a) the micro-entity has a past practice of settling by issuing equity instruments; or

(b) the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than, the **fair value** of the equity instrument.

In circumstances (a) and (b), the micro-entity shall account for the transaction as an equity-settled share-based payment transaction in accordance with paragraph 26.2A.

26.16 to 26.23 [Not used]

Section 27
Impairment of Assets

Objective and scope

27.1 An **impairment loss** occurs when the **carrying amount** of an **asset** exceeds its **recoverable amount**. This section shall be applied in accounting for the impairment of all assets other than the following, for which other sections of this [draft] FRS establish impairment requirements:

(a) assets arising from **construction contracts** (see Section 23 *Revenue*); and

(b) **financial assets** within the scope of Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*.

27.1A to 27.4 [Not used]

Impairment of assets

General principles

27.5 If, and only if, the recoverable amount of an asset is less than its carrying amount, the **micro-entity** shall reduce the carrying amount of the asset to its recoverable amount.

27.5A If it is not possible to estimate the recoverable amount of the individual asset, a micro-entity shall estimate the recoverable amount of the **cash-generating unit** to which the asset belongs. This may be the case because measuring the recoverable amount requires forecasting cash flows, and sometimes individual assets do not generate cash flows by themselves. Micro-entities with cash-generating units shall apply the relevant requirements of Section 27 *Impairments of Assets* of **FRS 102**.

27.6 A micro-entity shall recognise an impairment loss immediately in **profit or loss**.

Indicators of impairment

27.7 A micro-entity shall assess at each **reporting date** whether there is any indication that an asset may be impaired. If any such indication exists, the micro-entity shall estimate the recoverable amount of the asset. If there is no indication of impairment, it is not necessary to estimate the recoverable amount.

27.8 [Moved to 27.5A]

27.9 In assessing whether there is any indication that an asset may be impaired, a micro-entity shall consider, as a minimum, the following indications:

External sources of information

(a) During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use.

(b) Significant changes with an adverse effect on the micro-entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the micro-entity operates or in the market to which an asset is dedicated.

(c) Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect materially the discount rate used in calculating an asset's **value in use** and decrease the asset's **fair value less costs to sell**.

(d) The carrying amount of the net assets of the micro-entity is more than the estimated fair value of the micro-entity as a whole (such an estimate may have been made, for example, in relation to the potential sale of part or all of the micro-entity).

Internal sources of information

(e) Evidence is available of obsolescence or physical damage of an asset.

(f) Significant changes with an adverse effect on the micro-entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the **useful life** of an asset as finite rather than indefinite.

(g) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. In this context economic performance includes operating results and cash flows.

27.10 If there is an indication that an asset may be impaired, this may indicate that the micro-entity should review the remaining useful life, the **depreciation (amortisation)** method or the **residual value** for the asset and adjust it in accordance with the section of this [draft] FRS applicable to the asset (eg Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*), even if no impairment loss is recognised for the asset.

Measuring recoverable amount

27.11 The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

27.12 It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

27.13 If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal.

Fair value less costs to sell

27.14 Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. The best evidence of the fair value less costs to sell of an asset is a price in a binding sale agreement in an arm's length transaction or a market price in an **active market**. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that a micro-entity could obtain, at the reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, a micro-entity considers the outcome of recent transactions for similar assets within the same industry.

27.14A When determining an asset's fair value less costs to sell, consideration shall be given to any restrictions imposed on that asset. Costs to sell shall also include the cost of obtaining relaxation of a restriction where necessary in order to enable the asset to be sold. If a restriction would also apply to any potential purchaser of an asset, the **fair value** of the asset may be lower than that of an asset whose use is not restricted.

Value in use

27.15 Value in use is the **present value** of the future cash flows expected to be derived from an asset. This present value calculation involves the following steps:

(a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and

(b) applying the appropriate discount rate to those future cash flows.

27.16 [Not used]

27.17 In measuring value in use, estimates of future cash flows shall include:

(a) projections of cash inflows from the continuing use of the asset;

(b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and

(c) net cash flows, if any, expected to be received (or paid) for the disposal of the asset at the end of its useful life in an arm's length transaction between knowledgeable, willing parties.

The micro-entity may wish to use any recent financial budgets or forecasts to estimate the cash flows, if available, and extrapolate the projections using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified.

27.18 [Not used]

27.19 Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:

(a) a future **restructuring** to which a micro-entity is not yet committed; or

(b) improving or enhancing the asset's performance.

27.20 The discount rate(s) used in the present value calculation shall be a pre-tax rate(s) that reflect(s) current market assessments of:

(a) the time value of money; and

(b) the risks specific to the asset for which the future cash flow estimates have not been adjusted.

The discount rate(s) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted, to avoid double-counting.

27.20A to 27.27 [Not used]

Reversal of an impairment loss

27.28 An impairment loss recognised for **goodwill** shall not be reversed in a subsequent period[8].

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[8] Subject to additional changes that are expected to be made to the legislation.

27.29 For all assets other than goodwill, if the reasons for the impairment loss have ceased to apply, an impairment loss shall be reversed in a subsequent period. A micro-entity shall assess at each reporting date whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. Indications that an impairment loss may have decreased or may no longer exist are generally the opposite of those set out in paragraph 27.9. If any such indication exists, the micro-entity shall determine whether all or part of the prior impairment loss should be reversed.

Reversal where recoverable amount was estimated for an individual impaired asset

27.30 When the prior impairment loss was based on the recoverable amount of the individual impaired asset, the following requirements apply:

(a) The micro-entity shall estimate the recoverable amount of the asset at the current reporting date.

(b) If the estimated recoverable amount of the asset exceeds its carrying amount, the micro-entity shall increase the carrying amount to recoverable amount, subject to the limitation described in (c) below. That increase is a reversal of an impairment loss. The micro-entity shall recognise the reversal immediately in profit or loss.

(c) The reversal of an impairment loss shall not increase the carrying amount of the asset above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

(d) After a reversal of an impairment loss is recognised, the micro-entity shall adjust the depreciation (amortisation) charge for the asset in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

27.31 to 27.33A [Not used]

Section 28
Employee Benefits

Scope of this section

28.1 **Employee benefits** are all forms of consideration given by a **micro-entity** in exchange for service rendered by employees, including directors and management. This section applies to all employee benefits, except for **share-based payment transactions**, which are covered by Section 26 *Share-based Payment* . Employee benefits covered by this section will be one of the following four types:

(a) short-term employee benefits, which are employee benefits (other than **termination benefits**) that are expected to be settled wholly before twelve months after the end of the **reporting period** in which the employees render the related service;

(b) **post-employment benefits**, which are employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment;

(c) other long-term employee benefits, which are all employee benefits, other than short-term employee benefits, post-employment benefits and termination benefits; or

(d) termination benefits, which are employee benefits provided in exchange for the termination of an employee's employment as a result of either:

(i) a micro-entity's decision to terminate an employee's employment before the normal retirement date; or

(ii) an employee's decision to accept voluntary redundancy in exchange for those benefits.

28.2 [Not used]

General recognition principle for all employee benefits

28.3 A micro-entity shall recognise the cost of all employee benefits to which its employees have become entitled as a result of service rendered to the micro-entity during the reporting period:

(a) As a **liability**, after deducting amounts that have been paid directly to the employees. If the amount paid exceeds the obligation arising from service before the **reporting date**, a micro-entity shall recognise that excess as an **asset** to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

(b) As an **expense**, unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset such as **inventories** (for example in accordance with paragraph 13.8) or **property, plant and equipment** (in accordance with paragraph 17.10).

Short-term employee benefits

Examples

28.4 Short-term employee benefits include items such as the following, if expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service:

(a) wages, salaries and social security contributions;

(b) paid annual leave and paid sick leave;

(c) profit-sharing and bonuses; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Measurement of short-term benefits generally

28.5 When an employee has rendered service to a micro-entity during the reporting period, the micro-entity shall measure the amounts recognised in accordance with paragraph 28.3 at the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

Recognition and measurement: Short-term compensated absences

28.6 A micro-entity may compensate employees for absence for various reasons including annual leave and sick leave. Some short-term compensated absences accumulate – they can be carried forward and used in future periods if the employee does not use the current period's entitlement in full. Examples include annual leave and sick leave. A micro-entity shall recognise the expected cost of **accumulating compensated absences** when the employees render service that increases their entitlement to future compensated absences. The micro-entity shall measure the expected cost of accumulating compensated absences at the undiscounted additional amount that the micro-entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. The micro-entity shall present this amount as falling due within one year at the reporting date.

28.7 A micro-entity shall recognise the cost of other (non-accumulating) compensated absences when the absences occur. The micro-entity shall measure the cost of non-accumulating compensated absences at the undiscounted amount of salaries and wages paid or payable for the period of absence.

Recognition: Profit-sharing and bonus plans

28.8 A micro-entity shall recognise the expected cost of profit-sharing and bonus payments only when:

(a) the micro-entity has a present legal or **constructive obligation** to make such payments as a result of past events (this means that the micro-entity has no realistic alternative but to make the payments); and

(b) a reliable estimate of the obligation can be made.

Post-employment benefits: Distinction between defined contribution plans and defined benefit plans

28.9 Post-employment benefits include, for example:

(a) retirement benefits, such as pensions; and

(b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Arrangements whereby a micro-entity provides post-employment benefits are **post-employment benefit plans**. A micro-entity shall apply this section to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits. In some cases, these arrangements are imposed by law rather than by action of the micro-entity. In some cases, these arrangements arise from actions of the micro-entity even in the absence of a formal, documented plan.

28.10 Post-employment benefit plans are classified as either **defined contribution plans** or **defined benefit plans**, depending on their principal terms and conditions:

(a) Defined contribution plans are post-employment benefit plans under which a micro-entity pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by a micro-entity (and perhaps also the employee) to a post-employment benefit plan or to an insurer, together with investment returns arising from the contributions.

(b) Defined benefit plans are post-employment benefit plans other than defined contribution plans. Under defined benefit plans, the micro-entity's obligation is to provide the agreed benefits to current and former employees, and actuarial risk (that benefits will cost more or less than expected) and investment risk (that returns on assets set aside to fund the benefits will differ from expectations) are borne, in substance, by the micro-entity. If actuarial or investment experience is worse than expected, the micro-entity's obligation may be increased, and vice versa if actuarial or investment experience is better than expected.

28.11 [Not used]

28.11A [Moved to 28.13B]

28.12 [Not used]

Post-employment benefit plans

Recognition and measurement – requirements applicable to all plans

28.13 A micro-entity shall recognise the contribution payable for a period:

(a) As a liability, after deducting any amount already paid. If contribution payments exceed the contribution due for service before the reporting date, a micro-entity shall recognise that excess as an asset to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

(b) As an expense, unless another section of this [draft] FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

28.13A When contributions to a defined contribution or defined benefit plan are not expected to be settled wholly within 12 months after the end of the reporting period in which the employees render the related service, the liability shall be measured at the **present value** of the contributions payable using the methodology for selecting a discount rate specified in paragraph 28.17. The unwinding of the discount shall be recognised as interest expense in profit or loss in the period in which it arises.

Recognition and measurement – requirements applicable to defined benefit plans

28.13B When a micro-entity participates in a defined benefit plan (which may include a **multi-employer plan** or **state plan**) and has entered into an agreement with the plan that determines how the micro-entity will fund a deficit (such as a schedule of contributions), the micro-entity shall recognise a liability for the contributions payable that arise from the agreement (to the extent that they relate to the deficit) and the resulting expense in **profit or loss** in accordance with paragraphs 28.13 and 28.13A.

28.14 to 28.16 [Not used]

Discounting – requirements applicable to all plans

28.17 A micro-entity shall determine the rate used to discount the future payments by reference to market yields at the reporting date on high quality corporate bonds. In countries with no deep market in such bonds, the micro-entity shall use the market yields (at the reporting date) on government bonds. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated period of the future payments.

28.18 to 28.28 [Not used]

Other long-term employee benefits

28.29 Other long-term employee benefits include items such as the following, if not expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service:

(a) long-term paid absences such as long-service or sabbatical leave;

(b) other long-service benefits;

(c) long-term disability benefits;

(d) profit-sharing and bonuses; and

(e) deferred remuneration.

28.30 A micro-entity shall recognise a liability for other long-term employee benefits measured at the net total of the following amounts:

(a) the present value of the benefit obligation at the reporting date (calculated using the methodology for selecting a discount rate in paragraph 28.17); minus

(b) the **fair value** at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

A micro-entity shall recognise the change in the liability in profit or loss, except to the extent that this [draft] FRS requires or permits their inclusion in the cost of an asset.

Termination benefits

28.31 A micro-entity may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits.

Recognition

28.32 Because termination benefits do not provide a micro-entity with future economic benefits, a micro-entity shall recognise them as an expense in profit or loss immediately.

28.33 [Not used]

28.34 A micro-entity shall recognise termination benefits as a liability and an expense only when the micro-entity is demonstrably committed either:

(a) to terminate the employment of an employee or group of employees before the normal retirement date; or

(b) to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

28.35 A micro-entity is demonstrably committed to a termination only when the micro-entity has a detailed formal plan for the termination[9] and is without realistic possibility of withdrawal from the plan.

Measurement

28.36 A micro-entity shall measure termination benefits at the best estimate of the expenditure that would be required to settle the obligation at the reporting date. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.

28.37 When termination benefits are due more than 12 months after the end of the reporting period, they shall be measured at their discounted present value using the methodology for selecting a discount rate specified in paragraph 28.17.

28.38 [Not used]

Disclosures

28.39 to 28.40 [Not used]

28.40A A micro-entity shall separately disclose any commitments not recognised in the statement of financial position concerning pensions in accordance with paragraph 8.8(c), in particular when a micro-entity participates in a defined benefit **multi-employer plan** it shall:

(a) [Not used]

(b) include a description of the extent to which the micro-entity can be liable to the plan for other entities' obligations under the terms and conditions of the multi-employer plan.

(c) [Not used]

28.41 to 28.44 [Not used]

[9] An example of the features of a detailed formal plan for restructuring, which may include termination benefits, is given in paragraph 21.11C.

Section 29
Income Tax

Scope of this section

29.1 For the purpose of this [draft] FRS, **income tax** includes all domestic and foreign taxes that are based on **taxable profit**.

29.2 This section covers accounting for income tax. It requires a **micro-entity** to recognise the **current tax** consequences of transactions and other events that have been recognised in the financial statements. Current tax is tax payable (refundable) in respect of the taxable profit (tax loss) for the current period or past **reporting periods**. This section does not require micro-entities to recognise **deferred tax** which represents the future tax consequences of transactions and events recognised in the financial statements of the current and previous periods.

29.2A This section also covers accounting for value added tax (VAT) and other similar sales taxes, which are not income taxes.

Current tax

29.3 A micro-entity shall recognise a current tax liability for tax payable on taxable profit for the current and past periods. If the amount of tax paid for the current and past periods exceeds the amount of tax payable for those periods, the micro-entity shall recognise the excess as a current tax asset.

29.4 A micro-entity shall recognise a current tax asset for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.

29.5 A micro-entity shall measure a current tax liability (asset) at the amount of tax it expects to pay (recover) using the tax rates and laws that have been enacted or **substantively enacted** by the **reporting date**.

Deferred tax

29.6 A micro-entity is not required to account for deferred tax arising on **timing differences** at the reporting date.

29.7 to 29.16 [Not used]

Measurement of current tax

29.17 A micro-entity shall not discount current tax assets and liabilities.

Withholding tax on dividends

29.18 When a micro-entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. Outgoing dividends and similar amounts payable shall be recognised at an amount that includes any withholding tax but excludes other taxes, such as attributable tax credits.

29.19 Incoming dividends and similar income receivable shall be recognised at an amount that includes any withholding tax but excludes other taxes, such as attributable tax credits. Any withholding tax suffered shall be shown as part of the tax charge.

Value Added Tax ('VAT') and other similar sales taxes

29.20 **Turnover** shown in **profit or loss** shall exclude VAT and other similar sales taxes on taxable outputs and VAT imputed under the flat rate VAT scheme. **Expenses** shall exclude recoverable VAT and other similar recoverable sales taxes. Irrecoverable VAT allocable to **fixed assets** and to other items disclosed separately in the financial statements shall be included in their cost where practicable and **material**.

Presentation

Allocation in profit or loss

29.21 A micro-entity shall present changes in a current tax liability (asset) as **tax expense** (income).

29.22 and 29.23 [Not used]

Offsetting

29.24 A micro-entity shall offset current tax assets and current tax liabilities, if and only if, it has a legally enforceable right to set off the amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

29.24A to 29.27 [Not used]

Section 30
Foreign Currency Translation

Scope of this section

30.1 A **micro-entity** may have transactions in foreign currencies. This section prescribes how to include foreign currency transactions in the financial statements of a micro-entity. Where a micro-entity has a foreign branch, the micro-entity should refer to the requirements of Section 30 *Foreign Currency Translation* of **FRS 102** to determine if the foreign branch has a different functional currency, and if so, should apply the requirements of Section 30 of FRS 102 to those transactions undertaken by the foreign branch.

30.2 to 30.5 [Not used]

Reporting foreign currency transactions

Initial recognition

30.6 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when a micro-entity:

(a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(c) otherwise acquires or disposes of **assets**, or incurs or settles **liabilities**, denominated in a foreign currency.

30.7 A micro-entity shall record a foreign currency transaction by applying to the foreign currency amount the spot exchange rate at the date of the transaction unless:

(a) the transaction is to be settled at a contracted rate, in which case that rate shall be used; or

(b) where a trading transaction is covered by a related or matching forward contract, in which case the rate of exchange specified in that contract shall be used.

30.8 The date of a transaction is the date on which the transaction first qualifies for **recognition** in accordance with this [draft] FRS. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Reporting at the end of the subsequent reporting periods

30.9 At the end of each **reporting period**, unless it is applying a contracted rate in accordance with paragraph 30.7 a micro-entity shall:

(a) translate foreign currency **monetary items** using the **closing rate**; and

(b) translate non-monetary items that are measured in terms of historical cost in a foreign currency using the exchange rate at the date of the transaction.

30.10 A micro-entity shall recognise, in **profit or loss** in the period in which they arise, exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous periods.

30.11 to 30.27 [Not used]

Section 31
Hyperinflation

[Not used]

Section 32
Events after the End of the Reporting Period

Scope of this section

32.1 This section defines events after the end of the **reporting period** and sets out principles for recognising and measuring those events.

Events after the end of the reporting period defined

32.2 Events after the end of the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. There are two types of events:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the end of the reporting period); and

(b) those that are indicative of conditions that arose after the end of the reporting period (non-adjusting events after the end of the reporting period).

32.3 Events after the end of the reporting period include all events up to the date when the financial statements are authorised for issue, even if those events occur after the public announcement of **profit or loss** or other selected financial information.

Recognition and measurement

Adjusting events after the end of the reporting period

32.4 A **micro-entity** shall adjust the amounts recognised in its financial statements to reflect adjusting events after the end of the reporting period.

32.5 The following are examples of adjusting events after the end of the reporting period that require a micro-entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

(a) The settlement after the end of the reporting period of a court case that confirms that the micro-entity had a present obligation at the end of the reporting period. The micro-entity adjusts any previously recognised **provision** related to this court case in accordance with Section 21 *Provisions and Contingencies* or recognises a new provision. The micro-entity does not merely disclose a **contingent liability**. Rather, the settlement provides additional evidence to be considered in determining the provision that should be recognised at the end of the reporting period in accordance with Section 21.

(b) The receipt of information after the end of the reporting period indicating that an **asset** was impaired at the end of the reporting period, or that the amount of a previously recognised **impairment loss** for that asset needs to be adjusted. For example:

(i) the bankruptcy of a customer that occurs after the end of the reporting period usually confirms that a loss existed at the end of the reporting period on a trade receivable and that the micro-entity needs to adjust the **carrying amount** of the trade receivable; and

(ii) the sale of **inventories** after the end of the reporting period may give evidence about their selling price at the end of the reporting period for the purpose of assessing impairment at that date.

(c) The determination after the end of the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.

(d) The determination after the end of the reporting period of the amount of profit-sharing or bonus payments, if the micro-entity had a legal or **constructive obligation** at the end of the reporting period to make such payments as a result of events before that date (see Section 28 *Employee Benefits*.

(e) The discovery of fraud or **errors** that show that the financial statements are incorrect.

Non-adjusting events after the end of the reporting period

32.6 A micro-entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the end of the reporting period.

32.7 Examples of non-adjusting events after the end of the reporting period include:

(a) A decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Therefore, a micro-entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the micro-entity does not update the amounts disclosed for the investments as at the end of the reporting period.

(b) An amount that becomes receivable as a result of a favourable judgement or settlement of a court case after the **reporting date** but before the financial statements are authorised for issue. This would be a **contingent asset** at the reporting date (see paragraph 21.13). However, agreement on the amount of damages for a judgement that was reached before the reporting date, but was not previously recognised because the amount could not be measured reliably, may constitute an adjusting event.

Going concern

32.7A A micro-entity shall not prepare its financial statements on a **going concern** basis if management determines after the reporting period either that it intends to liquidate the micro-entity or to cease trading, or that it has no realistic alternative but to do so.

32.7B Deterioration in operating results and **financial position** after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this section requires a fundamental change in the basis of accounting.

Dividends

32.8 If a micro-entity declares dividends to holders of its equity instruments after the end of the reporting period, the micro-entity shall not recognise those dividends as a **liability** at the end of the reporting period because no obligation exists at that time. The amount of the dividend may be presented as a segregated component of retained earnings at the end of the reporting period.

32.9 to 32.11 [Not used]

Section 33
Related Party Disclosures[10]

[Not used]

[10] A micro-entity is legally required to provide the disclosures set out in paragraph 8.9 in relation to advances and credits granted to administrative, managerial and supervisory bodies.

Section 34
Specialised Activities

Scope of this section

34.1 This section sets out the financial reporting requirements for **micro-entities** involved in agriculture.

Agriculture

34.2 [Not used]

Recognition

34.3 A micro-entity that is engaged in **agricultural activity** shall recognise a **biological asset** or an item of **agricultural produce** when, and only when:

(a) the micro-entity controls the **asset** as a result of past events;

(b) it is **probable** that future economic benefits associated with the asset will flow to the micro-entity; and

(c) the cost of the asset can be measured reliably.

Measurement

34.3A to 34.7B [Not used]

34.8 A micro-entity shall measure biological assets at cost less any accumulated **depreciation** and any accumulated **impairment losses**.

34.9 In applying the requirements of paragraph 34.8, agricultural produce harvested from a micro-entity's biological assets shall be measured at the point of harvest at the lower of cost and estimated selling price less costs to complete and sell.

Such **measurement** is the cost at that date when applying Section 13 *Inventories* or another applicable section of this [draft] FRS.

34.10 to 34.97 [Not used]

Section 35
Transition to this [draft] FRS

Scope of this section

35.1 This section applies to a **first-time adopter of this [draft] FRS**, regardless of whether its previous accounting framework was **EU-adopted IFRS** or another set of generally accepted accounting principles (GAAP) such as its national accounting standards, or another framework such as the local **income tax** basis.

35.2 Notwithstanding the requirements in paragraphs 35.3 and 35.4 a **micro-entity** that has applied [draft] FRS 105 in a previous **reporting period**, but whose most recent previous annual financial statements were prepared in accordance with a different accounting framework, must either apply this section or else apply [draft] FRS 105 retrospectively in accordance with Section 10 *Accounting Policies, Changes in Estimates and Errors* as if the micro-entity had never stopped applying this [draft] FRS.

First-time adoption

35.3 A first-time adopter of this [draft] FRS shall apply this section in its first financial statements that conform to this [draft] FRS.

35.4 A micro-entity's first financial statements that conform to this [draft] FRS are the first financial statements[11] prepared in accordance with this [draft] FRS if, for example, the micro-entity:

(a) did not present financial statements for previous periods;

(b) presented its most recent previous financial statements under previous UK and Republic of Ireland requirements or **FRS 102** that are therefore not consistent with this [draft] FRS in all respects; or

(c) presented its most recent previous financial statements in conformity with EU-adopted IFRS.

35.5 Paragraph 3.17 defines a complete set of financial statements for a micro-entity.

35.6 Paragraph 3.14 requires a micro-entity to disclose, in a complete set of financial statements, comparative information in respect of the preceding period for all amounts presented in the financial statements. Therefore, a micro-entity's **date of transition** to this [draft] FRS is the beginning of the earliest period for which the micro-entity presents full comparative information in accordance with this [draft] FRS in its first financial statements that comply with this [draft] FRS.

Procedures for preparing financial statements at the date of transition

35.7 Except as provided in paragraphs 35.9 to 35.11, a micro-entity shall, in its opening **statement of financial position** as of its date of transition to this [draft] FRS (ie the beginning of the earliest period presented):

(a) recognise all **assets** and **liabilities** whose **recognition** is required by this [draft] FRS;

[11] This excludes interim financial statements.

(b) not recognise items as assets or liabilities if this [draft] FRS does not permit such recognition;

(c) reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of **equity**, but are a different type of asset, liability or component of equity under this [draft] FRS; and

(d) apply this [draft] FRS in measuring all recognised assets and liabilities.

This section does not require the opening statement of financial position to be presented.

35.8 The **accounting policies** that a micro-entity uses in its opening statement of financial position under this [draft] FRS may differ from those that it used for the same date using its previous financial reporting framework. The resulting adjustments arise from transactions, other events or conditions before the date of transition to this [draft] FRS. Therefore, a micro-entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to this [draft] FRS.

35.9 On first-time adoption of this [draft] FRS, a micro-entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

(a) ***Derecognition*** *of* ***financial assets*** *and* ***financial liabilities***:
Financial assets and liabilities derecognised under a micro-entity's previous accounting framework before the date of transition shall not be recognised upon adoption of this [draft] FRS. Conversely, for financial assets and liabilities that would have been derecognised under this [draft] FRS in a transaction that took place before the date of transition, but that were not derecognised under a micro-entity's previous accounting framework, a micro-entity may choose:

(i) to derecognise them on adoption of this [draft] FRS; or

(ii) to continue to recognise them until disposed of or settled.

(b) [Not used]

(c) *Accounting estimates*.

(d) to (e) [Not used]

35.10 A micro-entity may use one or more of the following exemptions in preparing its first financial statements that conform to this [draft] FRS:

(a) [Not used]

(b) ***Share-based payment transactions***

A first-time adopter is not required to apply Section 26 *Share-based Payment* to liabilities arising from **share-based payment transactions** that were settled before the date of transition to this [draft] FRS.

(c) to (f) [Not used]

(g) ***Compound financial instruments***

Paragraph 22.13 requires a micro-entity to split a **compound financial instrument** into its liability and equity components at the date of issue. A first-time adopter need not separate those two components if the liability component is not outstanding at the date of transition to this [draft] FRS.

(h) to (j) [Not used]

(k) ***Arrangements containing a lease***

A first-time adopter may elect to determine whether an arrangement existing at the date of transition to this [draft] FRS contains a **lease** (see paragraph 20.3A) on the basis of facts and circumstances existing at that date, rather than when the arrangement was entered into.

(l) ***Decommissioning liabilities included in the cost of property, plant and equipment***

Paragraph 17.10(c) states that the cost of an item of **property, plant and equipment** includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which a micro-entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce **inventories** during that period. A first-time adopter may elect to measure this component of the cost of an item of property, plant and equipment at the date of transition to this [draft] FRS, rather than on the date(s) when the obligation initially arose.

(m) ***Dormant companies***[12]

A company within the Companies Act definition of a dormant company may elect to retain its accounting policies for reported assets, liabilities and equity at the date of transition to this [draft] FRS until there is any change to those balances or the company undertakes any new transactions.

(n) to (o) [Not used]

(p) ***Lease incentives***

A first-time adopter is not required to apply paragraphs 20.15A and 20.25A to **lease incentives** provided the term of the lease commenced before the date of transition to this [draft] FRS. The first-time adopter shall continue to recognise any residual benefit or cost associated with these lease incentives on the same basis as that applied at the date of transition to this [draft] FRS.

(q) to (s) [Not used]

35.11 If it is **impracticable** for a micro-entity to restate the opening statement of financial position at the date of transition for one or more of the adjustments required by paragraph 35.7 the micro-entity shall apply paragraphs 35.7 to 35.10 for such adjustments in the earliest period for which it is practicable to do so, and shall identify the data presented for prior periods that are not comparable with data for the period in which it prepares its first financial statements that conform to this [draft] FRS. A micro-entity is not required to provide any disclosures required by this [draft] FRS for any period before the period in which it prepares its first financial statements that conform to this [draft] FRS if it is impracticable to do so.

35.11A Where applicable to the transactions, events or arrangements affected by applying these exemptions, a micro-entity may continue to use the exemptions that are applied at the date of transition to this [draft] FRS when preparing subsequent financial statements, until such time when the assets and liabilities associated with those transactions, events or arrangements are derecognised.

35.11B to 35.15 [Not used]

[12] Irish company law does not contain an equivalent definition.

The Accounting Council's Advice to the FRC to issue FRED 58

Introduction

1 This report provides an overview of the main issues that have been considered by the Accounting Council in advising the Financial Reporting Council (FRC) to issue FRED 58 *Draft FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime*, incorporating the Council's advice following these FRC consultations:

(a) Consultation Document *Accounting standards for small entities – Implementation of the EU Accounting Directive*; and

(b) FRED 50 *Draft FRC Abstract 1 Residential Management Companies' Financial Statements and Consequential Amendments to the FRSSE*.

2 The FRC, in accordance with the *Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012* (SI 2012/1741), is a prescribed body for issuing accounting standards in the UK. The *Foreword to Accounting Standards* sets out the application of accounting standards in the Republic of Ireland.

3 In accordance with the *FRC Codes and Standards: procedures*, any proposal to issue, amend or withdraw a code or standard is put to the FRC Board with the full advice of the relevant Councils and/or the Codes & Standards Committee. Ordinarily, the FRC Board will only reject the advice put to it where:

(a) it is apparent that a significant group of stakeholders has not been adequately consulted;

(b) the necessary assessment of the impact of the proposal has not been completed, including an analysis of costs and benefits;

(c) insufficient consideration has been given to the timing or cost of implementation; or

(d) the cumulative impact of a number of proposals would make the adoption of an otherwise satisfactory proposal inappropriate.

4 The FRC has established the Accounting Council as the relevant Council to assist it in the setting of accounting standards.

Advice

5 The Accounting Council is advising the FRC to issue FRED 58 *Draft FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime* to allow micro-entities to take advantage of the reduced presentation and disclosure requirements of the regime as currently set out in UK company law, whilst updating the recognition and measurement requirements in line with new UK GAAP (within the parameters of what is permitted under company law), and offering further simplification appropriate to micro-entities.

6 Draft FRS 105 has been developed from the recognition and measurement requirements of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. The Accounting Council's Advice on FRS 102 is contained in that standard.

Background

7 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), including exclusions from the regime. In addition, entities that are not established under company law may not apply the micro-entities regime.

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

9 The micro-entities regime was brought into UK legislation in November 2013 and is applicable for accounting periods ending on or after 30 September 2013, for companies filing their accounts on or after 1 December 2013.

10 If the micro-entities regime is introduced into Irish legislation, this draft FRS will also apply.

11 To facilitate the change in legislation in the UK, the FRC amended the Financial Reporting Standard for Smaller Entities (FRSSE) in April 2014 to reflect the new micro-entities regime as a temporary solution to enable micro-entities to apply the FRSSE if they chose to apply the micro-entities regime. The FRC noted when it issued the *Amendments to the FRSSE – Micro-entities*, that it was considering how best to present the requirements for micro-entities in the most user-friendly way in the longer term.

12 In September 2014, the FRC issued a consultation document *Accounting standards for small entities – Implementation of the EU Accounting Directive*[13] (the Consultation Document), outlining its proposal to develop a new stand-alone financial reporting standard for micro-entities. The Accounting Council has considered the responses to the Consultation Document in developing FRED 58.

13 In August 2013, the FRC issued a consultation, FRED 50, on residential management companies' financial statements. The Accounting Council has considered the responses to FRED 50 in developing FRED 58.

14 The FRC will produce a comprehensive feedback statement encompassing responses received to FRED 50, the Consultation Document, and to FREDs 58 to 60 on the implementation of the EU Accounting Directive when the final standards are issued.

Objective

15 The FRC gives careful consideration to its objective and the intended effects when developing new accounting standards or requirements for the UK and Republic of Ireland. In developing accounting standards, including draft FRS 105, the overriding objective of the FRC 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.

16 In meeting this objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) reflect up-to-date thinking and developments in the way businesses operate and the transactions they undertake;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

[13] Available on the FRC website (*www.frc.org.uk*).

A new standard based on FRS 102

17 The Consultation Document proposed the development of a new financial reporting standard for micro-entities, which would be developed from the recognition and measurement requirements of FRS 102. FRS 102 has been adapted to reflect the micro-entities regime as set out in company law and been simplified further to reflect the size and nature of companies that would qualify as micro-entities.

18 Respondents to the Consultation Document were strongly in favour of this direction of travel. The Accounting Council considered alternative options for revised accounting standards for small entities (including micro-entities), such as redrafting the FRSSE; however, it advises that new requirements for all small entities (including micro-entities) that are based on FRS 102 will improve consistency across the financial reporting framework in the UK and Republic of Ireland.

Amendments to align accounting treatment with legal requirements

Scope

19 The Accounting Council notes that the micro-entities regime only applies to micro-entities that are companies and cannot be applied by public benefit entities or financial institutions, and therefore advises that any public benefit entity or financial institution specific paragraphs / sections should be removed, most notably the following subsections from Section 34 *Specialised Activities*:

(a) *Financial Institutions*;

(b) *Retirement Benefit Plans: Financial Statements*;

(c) *Incoming Resources from Non-exchange Transactions*;

(d) *Public Benefit Entity Combinations*; and

(e) *Public Benefit Entity Concessionary Loans*.

20 The regime also 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 and the Accounting Council advises that the following sections are removed / amended as they are not applicable under the micro-entities regime:

(a) Section 1 *Scope* (to remove the reduced disclosure framework);

(b) Section 9 *Consolidated and Separate Financial Statements* (leaving only intermediate payment arrangements);

(c) Section 14 *Investments in Associates* (to cross refer to Section 11 *Basic Financial Instruments*);

(d) Section 15 *Investments in Joint Ventures* (to cross refer to Section 11 *Basic Financial Instruments* for jointly controlled entities); and

(e) Section 30 *Foreign Currency Translation* (to remove the section on the translation of a foreign operation).

21 The Accounting Council noted that it is possible for a micro-entity to enter into a trade and asset acquisition, however it would expect this to occur infrequently amongst micro-entities. Nonetheless the Accounting Council advises that a cross reference to Section 19 *Business Combinations and Goodwill* of FRS 102 is inserted into draft FRS 105 for the infrequent occasions where this may be relevant to a micro-entity.

Presentation of financial statements

22 The micro-entities regime only requires the preparation of a balance sheet (choice of 2 formats) and a profit and loss account (only 1 format). No other statements (for example a cash flow statement, statement of changes in equity or a statement in comprehensive income) can be mandated.

23 The Accounting Council advises that the following sections are removed / amended to reflect these legal requirements:

(a) Section 3 *Financial Statement Presentation*;

(b) Section 4 *Statement of Financial Position*;

(c) Section 5 *Statement of Comprehensive Income and Income Statement*;

(d) Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*; and

(e) Section 7 *Statement of Cash Flows.*

Recognition and measurement

24 The micro-entities regime does not permit the use of the Alternative Accounting Rules or the Fair Value Rules set out in company law and therefore micro-entities are not permitted to revalue or subsequently measure assets or liabilities at fair value.

25 The Accounting Council advises that FRS 102 is adapted to reflect the above requirements, removing any accounting treatment (either mandatory or optional in FRS 102) that requires or permits subsequent measurement at fair value. The key areas requiring change are as follows:

(a) Section 11 *Basic Financial Instruments* and *Section 12 Other Financial Instruments Issues* (all financial instruments, including derivatives are measured at cost or amortised cost).

(b) Section 16 *Investment Property* (all investment property must be measured under the cost model in Section 17 *Property Plant and Equipment*).

(c) Section 17 *Property Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill* (to remove the revaluation model).

(d) Section 34 *Specialised Activities – Agriculture* (to remove the fair value model).

26 Section 11 sets out the accounting requirements for all financial instruments, except derivatives which are accounted for in accordance with Section 12 (see below). Dependent on the type of financial instrument, they are either measured at cost or amortised cost. All financial assets are subject to impairment.

27 Section 12 clarifies the accounting requirements for derivative contracts. Derivatives include contracts such as options, forwards, futures and swaps. Where the costs of a derivative contract are recognised as an asset, the amount recognised is allocated to profit or loss on a systematic basis (usually straight line) over the term of the contract. A micro-entity provides for losses from derivative contracts when the contract is onerous in accordance with the requirements of Section 21 *Provisions and Contingencies.*

28 Further amendments are required to other sections such as to Section 30 *Foreign Currency Translation* to remove paragraphs in relation to foreign exchange gains and losses arising on recognised assets held at a revalued amount and Section 35 *Transition to this [draft] FRS* to remove any transitional exemptions related to fair value accounting (eg using fair value as deemed cost).

29 As noted in Appendix III: *Note on legal requirements* the requirement to initially (rather than subsequently) recognise assets or liabilities at fair value does not breach the requirements of the micro-entities regime as the use of a fair value is a method of estimating cost at initial recognition.

Disclosures

30 The micro-entities regime also specifies that only certain disclosures are required to be made, for example information in relation to financial commitments, guarantees and contingencies and advances and credits granted to directors. In addition, the financial statements prepared under the micro-entities regime are presumed to give a true and fair view.

31 The Accounting Council advises that Section 8 *Notes to the Financial Statements* is amended to include an explicit requirement to make the disclosures required by law and that all other non-mandatory disclosures are removed from draft FRS 105.

Further simplifications over and above legal requirements

32 The micro-entities regime is deregulatory and, in developing draft FRS 105, the Accounting Council believes it is appropriate to consider if further simplifications to the accounting treatments that would otherwise be based on FRS 102 are appropriate.

33 The Accounting Council considers that simplifications would be appropriate if:

(a) the burden of applying the accounting treatment in FRS 102 is not outweighed by the benefits for micro-entities and an alternative, more straightforward, treatment could be identified;

(b) the lack of detail in the formats of the financial statements and/or supporting disclosures would limit the understanding of the financial information presented; and/or

(c) transactions occur infrequently amongst micro-entities.

34 The Accounting Council notes that continuing to allow accounting policy choices adds complexity for preparers of a micro-entity's financial statements and would cause confusion to users due to the lack of detail in the formats of the financial statements and lack of supporting disclosures to explain the policy choice taken. As a result, the Accounting Council advises that all policy options are removed from draft FRS 105 and that the mandatory treatment should be the recognition of income and expenses in the income statement, rather than the deferral of assets/liabilities into the balance sheet, as this is more straightforward to apply.

35 In addition to the amendments required for alignment with the legal requirements, the Accounting Council advises that the following further simplifications for micro-entities in comparison to FRS 102 are appropriate:

(a) No requirement to account for deferred taxation.

(b) No requirement to account for equity-settled share-based payments prior to the issue of the shares.

(c) A simplification to accounting for post-employment benefits that will permit the contribution payable for the period to be accounted for as an expense for defined benefit plans as well as for defined contribution plans, although for defined benefit plans the requirement to recognise a liability for a schedule of contributions (to the extent that it relates to the deficit) is included.

(d) A simplification to the accounting for foreign currency transactions where the distinction between functional and presentation currency is removed, and as derivatives will not be recognised at fair value (and therefore hedge accounting as set out in FRS 102 is not applicable) micro-entities must use contracted rates (rather than spot rates at the transaction date) where available to achieve a similar effect.

(e) Deletion of the following sections that are unlikely to be applicable to micro-entities:

  (i) Section 31 *Hyperinflation;* and

  (ii) All subsections of Section 34 *Specialised Activities* except for *Agriculture.*

(f) No option to capitalise borrowing costs or development costs.

(g) No option to apply the accruals method for government grants.

(h) Simplifications in relation to the measurement of financial instruments at amortised cost and the accounting for transactions with non-market interest rates.

(i) Simplifications in relation to the assessment of impairment and the derecognition requirements applicable to financial assets.

(j) Simplified principles for classifying financial instruments as equity or debt.

Deferred taxation

36 The Accounting Council advises that it is appropriate to remove any requirement for micro-entities to account for deferred tax. The accounting treatment is complex, there will be a lack of detail in the formats of the financial statements to distinguish current tax from deferred tax and there will be insufficient disclosures to support the financial information presented.

Equity-settled share-based payments

37 The Accounting Council advises that because of the lack of supporting disclosures, micro-entities are not required to account for equity-settled share-based payments prior to any shares being issued.

Defined benefit pension schemes

38 The Accounting Council advises that it would be appropriate to simplify the accounting treatment of defined benefit schemes for micro-entities on the basis that it expects very few micro-entities to have such schemes. The Council advises that draft FRS 105 requires all defined benefit schemes to be accounted for by recognising the contribution payable for the period as an expense, as if they were defined contribution schemes, but also including recognition of a liability for contributions payable arising from an agreement to fund a deficit in relation to past service (such as a schedule of contributions).

Foreign currency transactions

39 The Accounting Council considers that it would be rare for a micro-entity to have a different functional and presentation currency and therefore advises that the distinction between the two is removed. In keeping with current accounting practice set out in the FRSSE, the Accounting Council notes that a contract rate should be used (rather than the spot rate on the transaction date) where one is available and appropriate.

40 In addition, the Council considers that it would be rare for a micro-entity to have a foreign branch and therefore advises that these requirements are also removed, albeit with a cross reference to FRS 102 for micro-entities where this situation is applicable.

Hyperinflation and specialised activities (extractive activities, service concessions, heritage assets and funding commitments)

41 The Accounting Council advises that these transactions are unlikely to occur in micro-entities and therefore it is appropriate to remove these sections from the standard.

Borrowing costs, development costs and government grants

42 The Accounting Council advises that it is appropriate to remove the policy options in relation to borrowing costs, development costs and government grants to reduce complexity for preparers. In addition, the lack of supporting disclosures and the condensed format of micro-entity financial statements will mean that users will not have sufficient information to determine and differentiate between different policy options. The removal of the policy options will therefore also aid understanding for users.

43 Therefore the Accounting Council advises that the options to capitalise borrowing costs, to capitalise development costs and to apply the accruals method for government grants are removed from draft FRS 105. The mandatory treatment will be to expense borrowing and development costs and to apply the performance method to government grants. The Accounting Council believes that these proposed mandatory treatments are the simplest to apply and understand.

Measurement of financial instruments

44 A small number of respondents to the Consultation Document requested a simplification in draft FRS 105 in relation to financing arrangements where below market rates of interest are offered, in particular in relation to transactions conducted between a micro-entity and its owner(s).

45 The Accounting Council considered this issue, in relation to both transactions with related parties and transactions with third parties and other possible simplications in respect of the measurement of financial instruments by micro-entities. The Accounting Council advises that micro-entities should not be required to impute a market rate of interest where transactions are conducted at below market rates of interest.

46 For arrangements where settlement is deferred beyond normal credit terms micro-entities are required to recognise interest on a straight-line basis. Transaction costs may be expensed immediately if they are considered not material otherwise they are recognised in profit or loss on a straight-line basis over the term of the contract.

47 The Accounting Council believes that these simplifications are appropriate in the context of the micro-entities regime and should make the accounting for financial instruments less complex for these entities.

Impairment and derecognition of financial assets

48 Micro-entities are required to assess financial assets for impairment annually and draft FRS 105 provides a list of indicative events of impairments. The Accounting Council believes that the proposed modifications make the requirements easier to understand and apply and that the requirements are adequate for micro-entities.

49 The derecognition requirements in FRS 102 include requirements that address situations where an entity has transferred control over a financial asset, despite having retained some significant risks and rewards of ownership. Transfers of financial assets that require these more complex accounting requirements are unlikely to be entered into regularly, if at all, by micro-entities. The Accounting Council therefore advises that the simpler conditions of draft FRS 105 which require a micro-entity to assess whether the contractual cash flows

have expired or have been settled, or whether substantially all of the risks and rewards of ownership have been transferred, are sufficient.

Classification principles for financial instruments

50 The classification of financial instruments as debt or equity can be challenging in practice because the terms and conditions of some instruments are very complex. To address this complexity, the requirements in FRS 102 are complicated and therefore may be difficult to understand. The Accounting Council believes that the financial instruments issued by micro-entities will be relatively simple in nature and that the more complex requirements in FRS 102 are therefore not necessary for micro-entities.

Determining accounting policies where draft FRS 105 does not contain requirements

51 The Accounting Council advises that where a micro-entity enters into a transaction that is not specifically included in the draft FRS 105, it shall refer to the concepts and pervasive principles set out in Section 2 *Concepts and Pervasive Principles* of draft FRS 105 in determining its accounting policies.

Transitional provisions – fair value / revaluation as deemed cost

52 The micro-entities regime permits micro-entities to apply only the historical cost accounting rules, which require fixed assets to be included at purchase price or production cost. Therefore the Accounting Council advises that it would be inconsistent with the new legal framework for micro-entities for draft FRS 105 to provide a transitional exemption to allow micro-entities to carry forward previous revaluations of property, plant and equipment or the fair value of investment properties or investments in shares as deemed cost.

53 The Accounting Council notes that the micro-entities regime is optional and that if a micro-entity wishes to retain revalued amounts in its financial statement it could continue to apply the small company regime, rather than moving to the micro-entities regime.

Residents' management companies (FRED 50)

54 In considering the feedback received from the FRC's consultation FRED 50, the Accounting Council noted there was no clear consensus on the correct accounting treatment for the preparation of the financial statements of residents' management companies[14]. Responses to FRED 50 can be found on the FRC website[15].

55 In its Consultation Document, the FRC proposed its intention to add a new subsection for residents' management companies (RMCs) into Section 34 *Specialised Activities* of FRS 102.

56 The Accounting Council notes that a significant majority of respondents did not agree with the proposal. The most compelling reasons given for not proceeding with the proposal were that:

[14] An organisation which may be referred to in the lease, which is responsible for the provision of services, and manages and arranges maintenance of the property, but which does not necessarily have any legal interest in the property. As the term implies, all or most of the members of a residents' management company will be leaseholders.

[15] FRED 50 document can be accessed here – http://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRED-50-Draft-FRC-Abstract-1-Residential-Managemen-File.pdf and responses to FRED 50 can be found here - https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRED-50-Draft-FRC-Abstract-1-Residential-Managemen/Responses-to-FRED-50.aspx.

(a) the issue is too narrow and industry-specific to be dealt with in an accounting standard and inclusion in Section 34 of FRS 102 would open up the FRC to specific requests that could result in the standard becoming unwieldy and difficult to apply; and

(b) interpretations of law and accounting standards should be issued by other means, with a significant number of respondents calling for an alternative solution such as sector-specific guidance developed by the FRC or the development of a Statement of Recommended Practice (SORP) by parties outside of the FRC.

57 The Accounting Council considers that UK financial reporting standards are in general principles-based (not rules-based) and that it expects preparers of financial statements to apply judgement in interpreting and applying its standards to reflect the impact of transactions that the reporting entity is party to.

58 Based on the feedback received, the Accounting Council considers that it is not appropriate to insert a new subsection into FRS 102 but that a clear statement of the legal position is of use. Therefore the Accounting Council advises that no change is made to FRS 102, or any other relevant financial reporting standard (including draft FRS 105).

59 For the avoidance of doubt, the Accounting Council advises that the FRC and the ICAEW have independently obtained legal opinions that state that residents' management companies act as principals, not agents, when transacting with third party suppliers in the management and arrangement of maintenance of a property and therefore it is not appropriate for an RMC to prepare dormant accounts if the RMC has entered into such transactions during the reporting period.

Effective date

60 In the UK, the effective date of the final version of FRS 105 will be aligned with the mandatory effective date for the new small companies regime and the supporting accounting standards (as proposed in FREDs 58 to 60), so that all new or revised accounting standards relating to the implementation of the EU Accounting Directive are effective from the same date. However, early application of draft FRS 105 will be available to any company permitted by law to apply the micro-entities regime and therefore in the UK it will be available from the date of its issue given that the relevant legislation has already been made.

61 See Appendix IV: Republic of Ireland (RoI) legal references for information on the applicability of the micro-entities regime in the Republic of Ireland.

Appendix I: Glossary

This glossary is an integral part of the [draft] Standard.

accounting policies	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
accrual basis (of accounting)	The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.
accumulating compensated absences	Compensated absences that are carried forward and can be used in future periods if the current period's entitlement is not used in full.
Act	The Companies Act 2006
active market	A market in which all the following conditions exist: (a) the items traded in the market are homogeneous; (b) willing buyers and sellers can normally be found at any time; and (c) prices are available to the public.
agent	An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. One feature indicating that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer.
agricultural activity	The management by an entity of the biological transformation of **biological assets** for sale, into **agricultural produce** or into additional biological assets.
agricultural produce	The harvested product of the entity's **biological assets**.
amortisation	The systematic allocation of the **depreciable amount** of an **asset** over its **useful life**.

amortised cost (of a financial asset or financial liability for the purposes of this [draft] FRS)	The amortised cost (for the purposes of this [draft] FRS) of a financial asset or financial liability is the net of the following amounts: (a) the transaction price; (b) plus, in the case of a financial asset, or minus in the case of a financial liability, **transaction costs** not yet recognised in **profit or loss**; (c) plus the cumulative interest income or expense recognised in profit or loss to date; (d) minus all repayments of principal and all interest payments or receipts to date; (e) minus, in the case of a financial asset, any reduction (directly or through the use of an allowance account) for impairment or uncollectability.
asset	A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
associate	An entity, including an unincorporated entity such as a partnership, over which the investor has **significant influence** and that is neither a **subsidiary** nor an interest in a **joint venture**.
biological asset	A living animal or plant.
borrowing costs	Interest and other costs incurred by an entity in connection with the borrowing of funds.
business	An integrated set of activities and **assets** conducted and managed for the purpose of providing: (a) a return to investors; or (b) lower costs or other economic benefits directly and proportionately to policyholders or participants. A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate **revenues**. If **goodwill** is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.
business combination	The bringing together of separate entities or **businesses** into one reporting entity.
carrying amount	The amount at which an **asset** or **liability** is recognised in the **statement of financial position**.
cash-generating unit	The smallest identifiable group of **assets** that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
cash-settled share-based payment transaction	A **share-based payment transaction** in which the entity acquires goods or services by incurring a **liability** to transfer cash or other **assets** to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity or another group entity.

change in accounting estimate	An adjustment of the **carrying amount** of an **asset** or a **liability**, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of **errors**.
closing rate	The spot exchange rate at the end of the **reporting period.**
commencement of lease term	The date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial **recognition** of the **lease** (ie the recognition of the **assets**, **liabilities**, **income** or **expenses** resulting from the lease, as appropriate).
compound financial instrument	A **financial instrument** that, from the issuer's perspective, contains both a **liability** and an **equity** element.
consolidated financial statements	The financial statements of a **parent** and its **subsidiaries** presented as those of a single economic entity.
construction contract	A contract specifically negotiated for the construction of an **asset** or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.
constructive obligation	An obligation that derives from an entity's actions where: (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities
contingent asset	A possible **asset** that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
contingent liability	(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not **probable** that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability.
contingent rent	That portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (eg percentage of future sales, amount of future use, future price indices, and future market rates of interest).

current tax	The amount of **income tax** payable (refundable) in respect of the **taxable profit (tax loss)** for the current period or past **reporting periods**.
date of transition	The beginning of the earliest period for which an entity presents full comparative information in a given standard in its first financial statements that comply with that standard.
deferred tax	Income tax payable (recoverable) in respect of the **taxable profit (tax loss)** for future **reporting periods** as a result of past transactions or events.
defined benefit plans	**Post-employment benefit plans** other than **defined contribution plans**.
defined contribution plans	**Post-employment benefit plans** under which an entity pays fixed contributions into a separate entity (a fund) and has no legal or **constructive obligation** to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient **assets** to pay all **employee benefits** relating to employee service in the current and prior periods.
depreciable amount	The cost of an **asset**, or other amount substituted for cost (in the financial statements), less its **residual value**.
depreciation	The systematic allocation of the **depreciable amount** of an **asset** over its **useful life**.
derecognition	The removal of a previously recognised **asset** or **liability** from an entity's **statement of financial position**.
development	The application of **research** findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.
employee benefits	All forms of consideration given by an entity in exchange for service rendered by employees.
equity	The residual interest in the **assets** of the entity after deducting all its **liabilities**.
equity-settled share-based payment transaction	A **share-based payment transaction** in which the entity: (a) receives goods or services as consideration for its own equity instruments (including shares or **share options**); or (b) receives goods or services but has no obligation to settle the transaction with the supplier.

errors	Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) was available when financial statements for those periods were authorised for issue; and (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
expenses	Decreases in economic benefits during the **reporting period** in the form of outflows or depletions of **assets** or incurrences of **liabilities** that result in decreases in **equity**, other than those relating to distributions to equity investors.
EU-adopted IFRS	IFRS that have been adopted in the European Union in accordance with EU Regulation 1606/2002.
fair value	The amount for which an **asset** could be exchanged, a **liability** settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction. In the absence of any specific guidance provided in the relevant section of this [draft] FRS, the guidance in paragraph 2.46A shall be used in determining fair value.
fair value less costs to sell	The amount obtainable from the sale of an **asset** in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.
finance lease	A **lease** that transfers substantially all the risks and rewards incidental to ownership of an **asset**. Title may or may not eventually be transferred. A lease that is not a finance lease is an **operating lease**.
financial asset	Any **asset** that is: (a) cash; (b) an equity instrument of another entity; (c) a contractual right: (i) to receive cash or another financial asset from another entity; or (ii) to exchange financial assets or **financial liabilities** with another entity under conditions that are potentially favourable to the entity; or (d) a contract that will or may be settled in the entity's own equity instruments and: (i) under which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or (ii) that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial guarantee contract	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the original or modified terms of a debt instrument.
financial instrument	A contract that gives rise to a **financial asset** of one entity and a **financial liability** or equity instrument of another entity.
financial liability	Any **liability** that is: (a) a contractual obligation: (i) to deliver cash or another **financial asset** to another entity; or (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, or (b) a contract that will or may be settled in the entity's own equity instruments and: (i) under which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or (ii) will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.
financial position	The relationship of the **assets**, **liabilities** and **equity** of an entity as reported in the **statement of financial position**.
first-time adopter of this [draft] FRS	An entity that presents its first annual financial statements that conform to this [draft] FRS, regardless of whether its previous accounting framework was **EU-adopted IFRS** or another set of accounting standards.
fixed assets	**Assets** of an entity which are intended for use on a continuing basis in the entity's activities.
FRS 102	FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland.*
gains	Increases in economic benefits that meet the definition of **income** but are not **revenue**.
going concern	An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.
goodwill	Future economic benefits arising from **assets** that are not capable of being individually identified and separately recognised.

government grant	Assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with specified conditions relating to the **operating activities** of the entity. Government refers to government, government agencies and similar bodies whether local, national or international.
grant date	The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other **assets**, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.
gross investment in a lease	The aggregate of: (a) the **minimum lease payments** receivable by the lessor under a **finance lease**; and (b) any unguaranteed **residual value** accruing to the lessor.
impairment loss	The amount by which the **carrying amount** of an **asset** exceeds: (a) in the case of **inventories**, its selling price less costs to complete and sell; (b) in the case of a **financial asset** measured at cost, the amount for which the asset can be sold; (c) in the case of a financial asset measured at **amortised cost**, the **present value** of estimated net cash flows; (d) in the case of a financial asset measured at the undiscounted amount of cash or other consideration to be received, the undiscounted amount of estimated future net cash flows; or (e) in the case of any other asset, its **recoverable amount**.
impracticable	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.
inception of the lease	The earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the **lease**.
income	Increases in economic benefits during the **reporting period** in the form of inflows or enhancements of **assets** or decreases of **liabilities** that result in increases in **equity**, other than those relating to contributions from equity investors.
income statement	**Financial statement** that presents all items of **income** and **expense** recognised in a **reporting period** (referred to as the profit and loss account in the **Act**).
income tax	All domestic and foreign taxes that are based on **taxable profits**. Income tax also includes taxes, such as withholding taxes, that are payable by a **subsidiary**, **associate** or **joint venture** on distributions to the reporting entity.

intangible asset	An identifiable non-monetary asset without physical substance. Such an **asset** is identifiable when: (a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or **liability**; or (b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
interest rate implicit in the lease	The discount rate that, at the **inception of the lease**, causes the aggregate **present value** of: (a) the **minimum lease payments**; and (b) the unguaranteed **residual value** to be equal to the sum of: (i) the **fair value** of the leased asset; and (ii) any initial direct costs of the lessor.
inventories	**Assets**: (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
investment property	Property (land or a building, or part of a building, or both) held by the owner or by the lessee under a **finance lease** to earn rentals or for capital appreciation or both, rather than for: (a) use in the production or supply of goods or services or for administrative purposes; or (b) sale in the ordinary course of business.
joint control	The contractually agreed sharing of **control** over an economic activity. It exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the **venturers**).
joint venture	A contractual arrangement whereby two or more parties undertake an economic activity that is subject to **joint control**. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or **jointly controlled entities**.
jointly controlled entity	A **joint venture** that involves the establishment of a corporation, partnership or other entity in which each **venturer** has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes **joint control** over the economic activity of the entity.
lease	An agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an **asset** for an agreed period of time.

lease incentives	Incentives provided by the lessor to the lessee to enter into a new or renew an **operating lease**. Examples of such incentives include up-front cash payments to the lessee, the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, leasehold improvements and costs associated with pre-existing lease commitments of the lessee), or initial periods of the **lease** provided by the lessor rent-free or at a reduced rent.
lease term	The non-cancellable period for which the lessee has contracted to **lease** the **asset** together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the **inception of the lease** it is reasonably certain that the lessee will exercise the option.
lessee's incremental borrowing rate (of interest)	The rate of interest the lessee would have to pay on a similar **lease** or, if that is not determinable, the rate that, at the **inception of the lease**, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the **asset**.
liability	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.
measurement	The process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the **statement of financial position** and **income statement**.
micro-entity	A company that qualifies as a micro-entity in accordance with section 384A of the **Act** and chooses to present the micro-entity minimum accounting items. Micro-entities are a subset of small companies as defined in the Act.
micro-entities regime	The legal requirements and exemptions relating to the preparation of Companies Act individual accounts of **micro-entities** as set out in the the **Act** and **Small Companies Regulations**.

minimum lease payments	The payments over the **lease term** that the lessee is or can be required to make, excluding **contingent rent**, costs for services and taxes to be paid by and reimbursed to the lessor, together with: (a) for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or (b) for a lessor, any **residual value** guaranteed to the lessor by: (i) the lessee; (ii) a party related to the lessee; or (iii) a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. However, if the lessee has an option to purchase the **asset** at a price that is expected to be sufficiently lower than **fair value** at the date the option becomes exercisable for it to be reasonably certain, at the **inception of the lease**, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.
monetary items	Units of currency held and **assets** and **liabilities** to be received or paid in a fixed or determinable number of units of currency.
multi-employer (benefit) plans	**Defined contribution plans** (other than **state plans**) or **defined benefit plans** (other than state plans) that: (a) pool the **assets** contributed by various entities that are not under common control; and (b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.
net investment in a lease	The **gross investment in a lease** discounted at the **interest rate implicit in the lease**.
non-exchange transaction	A transaction whereby an entity receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.
notes (to the financial statements prepared under this [draft] FRS)	Notes contain information in addition to that presented in the **statement of financial position** and **income statement**. Notes are required to be presented at the foot of the statement of financial position.
onerous contract	A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.
operating lease	A **lease** that does not transfer substantially all the risks and rewards incidental to ownership. A lease that is not an operating lease is a **finance lease**.

ordinary share	An equity instrument that is subordinate to all other classes of equity instrument.
owners	Holders of instruments classified as **equity**.
parent	An entity that has one or more **subsidiaries**.
performance	The relationship of the **income** and **expenses** of an entity, as reported in the **income statement**.
performance-related condition	A condition that requires the performance of a particular level of service or units of output to be delivered, with payment of, or entitlement to, the resources conditional on that performance.
post-employment benefits	**Employee benefits** (other than **termination benefits** and short-term employee benefits) that are payable after the completion of employment.
post-employment benefit plans	Formal or informal arrangements under which an entity provides **post-employment benefits** for one or more employees.
present value	A current estimate of the present discounted value of the future net **cash flows** in the normal course of business.
principal	An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that indicate that an entity is acting as a principal include: (a) the entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer; (b) the entity has inventory risk before or after the customer order, during shipping or on return; (c) the entity has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and (d) the entity bears the customer's credit risk for the amount receivable from the customer.
probable	More likely than not.
profit or loss	The total of **income** less **expenses**.
property, plant and equipment	Tangible assets that: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period.
prospectively (applying a change in accounting policy)	Applying the new **accounting policy** to transactions, other events and conditions occurring after the date as at which the policy is changed.

provision	A **liability** of uncertain timing or amount.
prudence	The inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that **assets** or **income** are not overstated and **liabilities** or **expenses** are not understated.
recognition	The process of incorporating in the **statement of financial position** or **income statement** an item that meets the definition of an **asset**, **liability**, **equity**, **income** or **expense** and satisfies the following criteria: (a) it is **probable** that any future economic benefit associated with the item will flow to or from the entity; and (b) the item has a cost or value that can be measured with reliability.
recoverable amount	The higher of an **asset's** (or **cash-generating unit's**) **fair value less costs to sell** and its **value in use**.
reporting date	The end of the latest period covered by financial statements or by an interim financial report.
reporting period	The period covered by financial statements or by an interim financial report.
research	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
residual value (of an asset)	The estimated amount that an entity would currently obtain from disposal of an **asset**, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its **useful life**.
restructuring	A restructuring is a programme that is planned and controlled by management and materially changes either: (a) the scope of a business undertaken by an entity; or (b) the manner in which that business is conducted.
retrospective application (of an accounting policy)	Applying a new **accounting policy** to transactions, other events and conditions as if that policy had always been applied.
revenue	The gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in **equity**, other than increases relating to contributions from equity participants.

share-based payment transaction	A transaction in which the entity: (a) receives goods or services (including employee services) as consideration for its own equity instruments (including shares or **share options**); or (b) receives goods or services but has no obligation to settle the transaction with supplier; or (c) acquires goods or services by incurring **liabilities** to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity or another group entity.
share option	A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specific period of time.
Small Companies Regulations	The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409).
state (employee benefit) plan	Employee benefit plans established by legislation to cover all entities (or all entities in a particular category, for example a specific industry) and operated by national or local government or by another body (for example an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity.
statement of financial position	**Financial statement** that presents the relationship of an entity's **assets**, **liabilities** and **equity** as of a specific date (referred to as the balance sheet in the **Act**).
subsidiary	An entity, including an unincorporated entity such as a partnership, that is **controlled** by another entity (known as the **parent**).
substantively enacted	Tax rates shall be regarded as substantively enacted when the remaining stages of the enactment process historically have not affected the outcome and are unlikely to do so. A UK tax rate shall be regarded as having been substantively enacted if it is included in either: (a) a Bill that has been passed by the House of Commons and is awaiting only passage through the House of Lords and Royal Assent; or (b) a resolution having statutory effect that has been passed under the Provisional Collection of Taxes Act 1968. (Such a resolution could be used to collect taxes at a new rate before that rate has been enacted. In practice, corporation tax rates are now set a year ahead to avoid having to invoke the Provisional Collection of Taxes Act for the quarterly payment system.) A Republic of Ireland tax rate can be regarded as having been substantively enacted if it is included in a Bill that has been passed by the Dail.
tax expense	The aggregate amount included in **profit or loss** or **equity** for the **reporting period** in respect of **current tax**.

taxable profit (tax loss)	The profit (loss) for a **reporting period** upon which **income taxes** are payable or recoverable, determined in accordance with the rules established by the taxation authorities. Taxable profit equals taxable income less amounts deductible from taxable income.
termination benefits	**Employee benefits** provided in exchange for the termination of an employee's employment as a result of either: (a) an entity's decision to terminate an employee's employment before the normal retirement date; or (b) an employee's decision to accept voluntary redundancy in exchange for those benefits.
timing differences	Differences between **taxable profits** and **profit or loss** as stated in the financial statements that arise from the inclusion of **income** and **expenses** in tax assessments in periods different from those in which they are recognised in financial statements.
transaction costs (financial instruments)	Incremental costs that are directly attributable to the acquisition, issue or disposal of a **financial asset** or **financial liability**, or the issue or reacquisition of an entity's **own equity instrument**. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial asset or financial liability, or had not issued or reacquired its own equity instrument.
treasury shares	An entity's own equity instruments, held by that entity or other members of the consolidated group.
turnover	The amounts derived from the provision of goods and services after deduction of: (a) trade discounts; (b) value added tax; and (c) any other taxes based on the amounts so derived.
useful life	The period over which an **asset** is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.
value in use	The **present value** of the future cash flows expected to be derived from an **asset** or **cash-generating unit**.
venturer	A party to a **joint venture** that has **joint control** over that joint venture.
vest	Become an entitlement. Under a share-based payment arrangement, a counterparty's right to receive cash, other **assets** or equity instruments of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.

Appendix II: Table of equivalence for UK Companies Act terminology

The following table compares company law terminology with broadly equivalent terminology used in this draft FRS. In some cases there are minor differences between the broadly equivalent definitions, which are also summarised below.

Company law terminology	**Draft FRS 105 terminology**
Accounting reference date	Reporting date
Accounts	Financial statements
Balance sheet	Statement of financial position
Capital and reserves	Equity
Cash at bank and in hand	Cash
Debtors	Trade receivables
Diminution in value [of assets]	Impairment
Financial year	Reporting period
Net realisable value [of any current asset]	Estimated selling price less costs to complete and sell
Profit and loss account	Income statement
Stocks	Inventories
Tangible assets	Includes: Property, plant equipment; Investment property
Trade creditors	Trade payables

Appendix III: Note on legal requirements

Introduction

A3.1 This appendix provides an overview of how the requirements of draft FRS 105 address UK company law requirements. It is therefore written from the perspective of a company to which the *Small Companies (Micro-Entities' Accounts) Regulations 2013* (SI 2013/3008) (the Micro-entities' Accounts Regulations) apply. Appendix IV contains the Republic of Ireland legal references.

A3.2 Accounting standards are applicable to the preparation of the financial statements of an entity that are intended, or in the case of a micro-entity are presumed, to give a true and fair view. However, it should be noted that the requirements of draft FRS 105 may also be appropriate for the preparation of financial information by other reporters of a similar size if appropriate in the circumstances.

A3.3 The Micro-entities' Accounts Regulations were made in November 2013 in the UK and apply to the financial statements of micro-entities for accounting periods ending on or after 30 September 2013 for companies filing their accounts on or after 1 December 2013.

A3.4 The definition of a micro-entity is contained in sections 384A and 384B of the Companies Act 2006. The qualifying conditions are met by a company in a year in which it does not exceed two or more of the following criteria:

(a)	Turnover	£632,000
(b)	Balance sheet total	£316,000
(c)	Number of employees	10

A3.5 For any company, other than a newly incorporated company, to qualify as a micro-entity, the qualifying conditions must be met for two consecutive years. A company will cease to qualify as a micro-entity if it fails to meet the qualifying conditions for two consecutive years. However, if a company which qualified as a micro-entity in one period no longer meets the criteria for a micro-entity in the next period, the company may continue to claim the exemptions available in the next period. If that company then reverts back to being a micro-entity by meeting the criteria, the exemptions will continue uninterrupted.

A3.6 Certain companies are excluded by section 384B of the Companies Act 2006 from being treated as micro-entities, including those excluded from the small companies regime for reasons of public interest (as set out in section 384), certain financial institutions, charities, those voluntarily preparing group accounts and those included in group accounts. The Act should be referred to for a full list of excluded companies.

A3.7 Entities that are not companies, such as limited liability partnerships (LLPs), do not meet the definition of a micro-entity.

Applicable accounting framework

A3.8 Accounts prepared in accordance with draft FRS 105 are classified as 'Companies Act individual accounts' for the purposes of section 395 of the Act and are therefore required to comply with the applicable provisions of Parts 15 and 16 of the Act and with the Micro-entities' Accounts Regulations.

Fair value at initial recognition

A3.9 The Micro-entities Accounts Regulations state that micro-entities are not permitted to apply the Alternative Accounting Rules or the Fair Value Rules as set out in company law. Therefore micro-entities are only permitted to apply the Historical Cost Accounting Rules.

A3.10 Draft FRS 105 states that certain types of assets and liabilities must be measured at fair value at initial recognition, for example inventories acquired through a non-exchange transaction. This does not breach the prohibition against fair value accounting as the use of a fair value is a method of estimating cost at initial recognition.

Distributable profits

A3.11 The determination of profits available for distribution is a complex area where accounting and company law interface. In determining profits available for distribution any entity may refer to Technical Release 02/10 *Guidance on realised and distributable profits under the Companies Act 2006* issued by the Institute of Chartered Accountants in England and Wales and the Institute of Chartered Accountants of Scotland, or any successor document, to determine profits available for distribution.

Appendix IV: Republic of Ireland (RoI) legal references

A4.1 At the time of writing, the micro-entities legislation is not available for application in the Republic of Ireland. However, the Irish Department of Jobs, Enterprise and Innovation (DJEI) have consulted on the possible enactment of this legislation in its C*onsultation on the transposition of the EU Accounting Directive 2013/34/EU*.

A4.2 If the DJEI decide to enact the micro-entities legislation, the final version of FRS 105 will be available for application in line with the effective date of the relevant legislation.

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