

November 2012

Foreword to Accounting Standards

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.

The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

© The Financial Reporting Council Limited 2012

The Financial Reporting Council Limited is a company limited by guarantee.

Registered in England number 2486368.

Registered Office: 5th Floor, Aldwych House, 71-91 Aldwych, London WC2B 4HN.

Foreword to Accounting Standards

Foreword to Accounting Standards

Introduction

- 1 This foreword explains the authority, scope and application of accounting standards issued by the Financial Reporting Council (FRC). The foreword supplements the procedure by which the FRC issues accounting standards which is set out in *FRC Codes & Standards: Procedures*, and considers the accounting standards' relationship to International Accounting Standards, issued by the International Accounting Standards Board. The foreword does not address situations where accounting standards other than those issued by the FRC are being applied, although similar considerations may nevertheless apply.
- 2 In accordance with the transitional provisions set out in the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012 (SI 2012/1741) the eight extant Statements of Standard Accounting Practice (SSAPs), the 29 extant Financial Reporting Standards (FRSs), the Financial Reporting Standard for Smaller Entities (effective April 2008) (FRSSE) and the 31 extant UITF Abstracts issued or adopted by the Accounting Standards Board¹ are treated as accounting standards issued by the FRC, unless they are subsequently withdrawn.
- 3 Accounting standards developed by the FRC are designated Financial Reporting Standards (FRSs). Accounting standards developed prior to the designation FRS continue to be known as SSAPs.
- 4 The FRC may issue pronouncements other than FRSs, including FRC Abstracts, which have the status of accounting standards. Abstracts issued prior to the designation FRC Abstracts continue to have the status of accounting standards and be known as UITF Abstracts. The FRC will indicate the authority, scope and application of pronouncements other than FRSs and FRC Abstracts as they are issued.

The role of the Financial Reporting Council

- 5 The role of the FRC is set out in *FRC Codes & Standards: Procedures*.
- 6 In relation to the setting of accounting standards the FRC has identified the following objective:

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

Authority of accounting standards

- 7 SSAPs, FRSs, the FRSSE, UITF Abstracts and FRC Abstracts issued by the FRC are 'accounting standards' for the purposes of the Companies Act 2006 (the Act) and Regulations² made thereunder, which require Companies Act accounts³, other than those prepared by small or medium-sized companies (as defined by the Act), to state whether they have been prepared in accordance with applicable accounting standards and to give particulars of any material departure from those standards and the reasons for it.

¹ Prior to 2 July 2012 accounting standards in the United Kingdom were issued by the body known as the Accounting Standards Board established under the articles of association of The Financial Reporting Council Limited.

² The Regulations are the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409) and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410).

³ The Foreword to Accounting Standards is applicable to Companies Act accounts prepared in accordance with the Act. IAS accounts, prepared in accordance with the IAS Regulation or the Act, apply international accounting standards.

- 8 Directors of companies incorporated under the Act are required by the Act to prepare financial statements that give a true and fair view of the state of affairs of the company, and where applicable the group, at the end of the financial year and of the profit or loss of the company or the group for the financial year.
- 9 The member bodies of the Consultative Committee of Accountancy Bodies⁴ (CCAB) and the Chartered Institute of Management Accountants (CIMA) are committed to promoting and supporting compliance with accounting standards by their members, whether as preparers or auditors of financial information.
- 10 The Councils of the CCAB bodies and CIMA therefore expect their members who assume responsibilities in respect of financial statements to observe accounting standards. The Councils have agreed that:
- a) Where this responsibility is evidenced by the association of members' names with such financial statements in the capacity of directors or other officers, other than auditors, the onus will be on them to ensure that the existence and purpose of accounting standards are fully understood by fellow directors and other officers. Members should also use their best endeavours to ensure that accounting standards are observed and that significant departures found to be necessary are adequately disclosed and explained in the financial statements.
 - b) Where members act as auditors or reporting accountants, they should be in a position to justify significant departures to the extent that their concurrence with the departures is stated or implied. They are not, however, required to refer in their report to departures with which they concur, provided that adequate disclosure has been made in the notes to the financial statements.
- 11 The CCAB bodies and CIMA, through appropriate committees, may enquire into apparent failures by their members to observe accounting standards or to ensure adequate disclosure of significant departures.
- 12 The FRC notes the continuing application of accounting standards in the Republic of Ireland through their ongoing promulgation by the Institute of Chartered Accountants in Ireland (ICAI). The objective of the FRC and ICAI is a regime of accounting standards common to both the United Kingdom and the Republic of Ireland.

Scope and application of accounting standards

- 13 Accounting standards are applicable to financial statements of a reporting entity⁵ that are intended to give a true and fair view⁶ of its state of affairs at the balance sheet date and of its profit or loss (or income and expenditure) for the financial period ending on that date. Accounting standards need not be applied to immaterial items.
- 14 Accounting standards should be applied to United Kingdom and Republic of Ireland group financial statements (including any amounts relating to overseas entities that are included in those financial statements). Accounting standards are not intended to apply to financial statements of overseas entities prepared for local purposes.

⁴ The member bodies of the CCAB are: the Association of Chartered Certified Accountants (ACCA); the Chartered Institute of Public Finance and Accountancy (CIPFA); the Institute of Chartered Accountants in England and Wales (ICAEW); the Institute of Chartered Accountants in Ireland (ICAI) and the Institute of Chartered Accountants of Scotland (ICAS).

⁵ This includes entities incorporated under the Act and preparing Companies Act accounts, and also entities that are not constituted as companies, but that are otherwise required to prepare financial statements that are intended to give a true and fair view.

⁶ More information about the 'true and fair' concept can be found on the FRC's website at <http://frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/True-and-Fair.aspx>.

- 15 Where accounting standards prescribe information to be contained in financial statements, such requirements do not override exemptions from disclosure given by law to, and utilised by, certain types of entity.

Compliance with accounting standards

- 16 Accounting standards are authoritative statements of how particular types of transactions and other events should be reflected in financial statements and accordingly compliance with accounting standards will normally be necessary for financial statements to give a true and fair view.
- 17 In applying accounting standards it is important to be guided by the spirit and reasoning behind them. The spirit and reasoning are set out in the material accompanying individual FRSs or FRC Abstracts.
- 18 The requirement to give a true and fair view may in special circumstances require a departure from accounting standards. However, because accounting standards are formulated with the objective of ensuring that the information resulting from their application faithfully represents the underlying commercial activity, the FRC envisages that only in exceptional circumstances will departure from the requirements of an accounting standard be necessary in order for financial statements to give a true and fair view.
- 19 If in extremely rare circumstances compliance with the requirements of an accounting standard is inconsistent with the requirement to give a true and fair view, the requirements of the accounting standard should be departed from to the extent necessary to give a true and fair view. In such cases informed and unbiased judgement should be used to devise an appropriate alternative treatment, which should be consistent with the economic and commercial characteristics of the circumstances concerned. Particulars of any material departure from an accounting standard, the reasons for it and its financial effects should be disclosed in the financial statements. The disclosure made should be equivalent to that given in respect of departures from specific accounting provisions of company law.
- 20 The FRC, through its Conduct Committee, and the Department for Business, Innovation and Skills have procedures for receiving and investigating complaints regarding the annual financial statements of companies in respect of apparent departures from the accounting requirements of the Act, including the requirement to give a true and fair view. The Conduct Committee also proactively selects a sample of company directors' reports and financial statements every year to review them for compliance with the law. The Committee is concerned with material departures from accounting standards, where, as a result, the accounts in question may not give a true and fair view, but it also covers other departures from the Accounts and reports provisions of the Act (Part 15 of the Act). The Conduct Committee is empowered by regulations made under the Act to apply to the court for a declaration or declarator that the annual accounts or directors' report of a company do not comply with the requirements of the Act and an order requiring the directors of the company to prepare revised accounts or report. The Department for Business, Innovation and Skills has similar powers.

The public sector

- 21 The financial reporting framework for the public sector in the United Kingdom is determined by the Relevant Authorities⁷. The framework requires the preparation of financial statements in accordance with EU-adopted IFRS, adapted where necessary in the public sector context. The public sector includes those entities classified to the public

⁷ The Relevant Authorities are HM Treasury, the Welsh Assembly Government, the Scottish Government, the Northern Ireland Assembly, CIPFA/LASAAC, the Department of Health and Monitor (Independent Regulator for NHS Foundation Trusts).

sector by the Office for National Statistics. Most public corporations are required, or have agreed, to apply EU-adopted IFRS in full.

- 22 In the Republic of Ireland accounting standards will normally be applicable to reporting entities in the public sector as such entities are either established under company law or are established under special legislation which requires them to produce financial statements which give a true and fair view.

Applicability of an accounting standard to transactions entered into before the standard was issued

- 23 When a new accounting standard is issued the question arises whether its provisions should be applied to transactions which took place prior to the promulgation of the standard. The general policy of the FRC is that the provisions of accounting standards should be applied to all material transactions irrespective of the date at which they are entered into. This is because exemption of certain transactions leads to similar transactions being accounted for differently in the same set of accounts, and can also hinder the comparison of the accounts of one entity with another.
- 24 In a few instances, application of the provisions of accounting standards to past transactions will entail a considerable amount of work and may result in information which is difficult for the user of accounts to interpret. In such a case, in drafting the standard the FRC will consider incorporating transitional provisions that provide an exclusion for transactions which took place prior to the promulgation of the standard.
- 25 In some instances, a new standard may have unforeseen consequences where financial statements are used to monitor compliance with contracts and agreements. The most widespread example is the covenants contained in banking and loan agreements, which may impose limits on measures such as net worth or gearing as shown in the borrower's financial statements.
- 26 The FRC considers that the developing nature of accounting requirements is a long-established fact that would be known to the parties when they entered into the agreement. It is up to the parties to determine whether the agreement should be insulated from the effects of a future accounting standard or, if not, the manner in which it might be renegotiated to reflect changes in reporting rather than changes in the underlying financial position.⁸ The FRC, therefore, has no general policy of exempting transactions occurring before a specific date from the requirements of new accounting standards.

Early adoption of Financial Reporting Exposure Drafts⁹

- 27 An exposure draft is issued for comment and is subject to revision. Until it is converted into an accounting standard the requirements of any existing accounting standards that would be affected by proposals in the exposure draft remain in force.
- 28 Some companies or other reporting entities may wish to provide additional information reflecting proposals in an exposure draft. In the FRC's view there are two ways that this can be achieved:
- a) Insofar as the information does not conflict with existing accounting standards, it could be incorporated into the financial statements. It should be remembered, however, that the proposals may change before forming part of an accounting standard and the consequences of a change to the proposals should be considered.

⁸ The British Bankers' Association has indicated that it does not believe that problems arising from breaches in covenants consequent upon changes in accounting policies will occur frequently in practice.

⁹ Similar considerations apply to discussion documents issued by the FRC.

- b) The information could be provided in supplementary form.

International Accounting Standards

- 29 Accounting standards are formulated with due regard to international developments. Indeed, in developing future accounting standards the FRC aims to provide accounting standards that have consistency with international accounting standards through the application of an IFRS-based solution, unless an alternative clearly better meets its overriding objective.

Withdrawal of Foreword to Accounting Standards (issued June 1993)

- 30 The *Foreword to Accounting Standards* issued by the ASB in June 1993, is superseded by this Foreword and is accordingly withdrawn.



Further copies, £5.00 (post-free) can be obtained from:

FRC Publications

145 London Road
Kingston upon Thames
Surrey
KT2 6SR

Tel: 020 8247 1264

Fax: 020 8547 2638

Email: cch@wolterskluwer.co.uk

Or order online at: www.frcpublications.com

ISBN 978-1-84798-612-2



UP/ASBD-BI12528