



FRED 59: DRAFT AMENDMENTS TO FRS 102 – SMALL ENTITIES AND OTHER MINOR AMENDMENTS

ICAEW welcomes the opportunity to comment on the exposure draft *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*, published by the Financial Reporting Council in February 2015, a copy of which is available from this [link](#).

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MAJOR POINTS

Continued support for the new regime

1. In our response to the 2014 Financial Reporting Council (FRC) consultation paper *Accounting standards for small entities: implementation of the EU Accounting Directive*, we broadly supported plans to bring small entities within the scope of FRS 102 *The Financial Reporting Standard Applicable in the UK and Republic of Ireland*, withdraw the FRSSE and issue a separate standard for eligible companies choosing to apply the micro-entities regime. In our view, reached after extensive consultation with our members, the proposed new regime would reduce training costs for all stakeholders, improve comparability between different-sized entities and facilitate an easier transition in accounting terms as businesses grow.
2. We did, however, express doubts over the proposed timetable for transition to the new regime and highlighted some concerns over the proposal that there would be no accounting simplifications to FRS 102 for small entities. Although not suggesting any simplifications, we instead recommended that amendments be not simply ruled out in principle if specific issues were identified, and also called for the FRC to consider the extent of flexibility of transitional provisions that should be made available for small entities.
3. Overall our general views remain in line with those expressed previously, although we have throughout our deliberations been very conscious of the fact that the UK financial reporting framework for small entities is undergoing nothing less than a fundamental shift, largely driven by the changes in UK company law arising from the new EU Accounting Directive. The small company accounting thresholds are set to increase and as a result, much ‘larger’ entities of some economic significance now qualify as ‘small’. Conversely, the introduction of the micro-entities regime in 2013 means those very small companies can now choose to prepare highly simplified accounts.
4. It is from this starting point that we have considered draft Section 1A *Small Entities* and the other detailed amendments to FRS 102. We have focused on the structure and layout of the amendments, taking into consideration whether the revised standard will be a user-friendly, coherent and clear document. We have also reflected upon the requirements and complexities of the revised small companies regime and how these have been incorporated into FRS 102. In particular, the fact that small company accounts must still show a true and fair view while perversely the law places restrictions on the amount of information that can be required by law in those accounts. This is likely to prove a major challenge for some entities classified as small.
5. Given the number of entities affected by these proposals, and the economic significance in the UK of small businesses, it is vitally important to ensure that the transition to the new regime is as smooth as possible and that there is no reduction in the usefulness of small company financial statements. With this in mind, we have through our deliberations identified a number of concerns regarding the amendments proposed to FRS 102, the most significant relating to Section 1A, as discussed below.

User-friendly, coherent and clear

6. We agree with the decision to add a new section to FRS 102 which sets out the reduced presentation and disclosure requirements for small entities. However, we have significant concerns over the proposed structure, layout, and in some places the drafting of this section which, in our view, does not clearly identify the disclosures required by law or their interaction with FRS 102.
7. We are particularly concerned with the lack of a clear, up-front explanation of the requirement for small company accounts to show a true and fair view despite the restriction on the specific information that can be required by law in those accounts. Also, with the lack of a clear explanation of the different legal restrictions which apply to the accounts of a small company

compared to those entities which, though small within the definition of the thresholds, are not in fact companies.

8. In our view, Section 1A should start with a brief summary of the revised small companies regime, including an explanation of the specific legal restrictions applying to small companies but not to other small entities. This would put the remainder of the section and indeed FRS 102 generally into context for small entity users of the standard. Furthermore, we believe that Section 1A should be restructured to be more user-friendly. This could be achieved, for example, by reproducing a complete and clear list of the small company disclosures required by law, ideally with the same wording used in the Companies Act and appropriate references. Each item could then be followed by a brief explanation of how the requirement interacts with the rest of FRS 102. We have included an example of how this revised structure and layout might appear in Appendix 1.

RESPONSES TO SPECIFIC QUESTIONS

Question 1:

Do you agree that the proposed Section 1A Small Entities adequately reflects the new small companies regime set out in company law and that the disclosure requirements for small entities are clear? If not, why not and what alternative approach would you propose?

9. In general, we agree that adding a new section to FRS 102 is a sensible way to deal with the reduced presentation and disclosure requirements for small entities under the revised regime. In addition, we agree that this section should outline all of the company law reporting requirements relating to the financial statements of small companies. However, while we consider Section 1A to be a step in the right direction, we do not believe that the proposed structure, layout, and in some places the drafting clearly set out the legal requirements or their interaction with the requirements of FRS 102. Indeed, we find it extremely difficult to read and not very user-friendly. Our concerns are discussed in more detail below.

Context and scope

10. The interaction between the legal restriction on information that can be required in small company accounts and the requirement for those accounts to show a true and fair view will, in our view, represent a significant challenge for many small companies. However, we do not believe that this interaction (and potential conflict) is explained in a logical or clear manner in Section 1A.
11. For example, the issue is first raised in proposed paragraphs 1A.6 and 1A.10, but without proper explanation and only in relation to the choice to prepare an abridged balance sheet or profit and loss account. Even then, these paragraphs only cross-refer to proposed paragraph 1A.12 (half way through the section), which briefly outlines how the notes to the financial statements must enable the financial statements to meet the requirement to give a true and fair view, but without any explanation of what this means in practice.
12. In our view, it would be far more useful if Section 1A were to start with a brief overview of the revised small companies regime, putting that section (and indeed the rest of FRS 102) into context. It is critical that all small *entity* users (as defined in the revised glossary to FRS 102) understand what information is required by law in small *company* accounts. This will thus provide the necessary context for those entities applying Section 1A which, though small within the definition of the thresholds, are not in fact companies and not therefore subject to the same legal restriction on the information that can be mandated in small company accounts. The overview should explain clearly why, for small entities applying Section 1A of FRS 102, some information is mandatory, other information is encouraged, and further information may need to be considered (and possibly disclosed) in order for the financial statements to present a true and fair view. Clarity for the various types of small entity is paramount here, not least the large population of small charities, which are not permitted to apply the micro-entities regime and will therefore be subject to FRS 102.

Structure and layout

13. In our opinion, the structure and layout of Section 1A are not user-friendly. In particular, it is not clear what information is required to satisfy the minimum disclosures as set out in proposed paragraph 1A.14 or how these minimum disclosures relate to the underlying legal requirements. For example, the FRC has outlined 22 separate disclosure items which cross-refer to paragraphs elsewhere in FRS 102, but with no further explanation of the information required or details of the legal requirement to which it relates. In our view, this approach is disjointed and may result in confusion for users of Section 1A since they will not easily be able to assess the adequacy of their disclosure without knowing the legal starting point.
14. We believe the requirements would be more accessible if structured as a clear and full list showing the legal requirements, with the same wording used in the Companies Act (where appropriate) and a cross-reference to the relevant section of the legislation. Where possible, disclosures of a similar nature should be grouped together. Use could also be made of sub-headings and bullet points when more than one area of FRS 102 may be relevant for a particular minimum disclosure requirement. Alternatively, a tabular format might be considered.
15. Each disclosure requirement could be followed by an explanation of how it interacts with the rest of FRS 102 and, if necessary, further guidance could be given. While this approach may increase the length of Section 1A we believe it would result in a far more user-friendly, coherent and clear document for small entities. It may also be useful for the FRC to introduce standard introductory words at the beginning of each section or disclosure requirement which is not mandated, but *encouraged*, in order that users understand the meaning and impact of this difference.
16. An example of how the suggested layout might appear is set out in Appendix 1.

Drafting

17. We do not agree with proposed paragraph 1A.4, which encourages a small entity to present a Statement of Changes in Equity. In our view, only those statements that are required by law should appear under the sub-heading of 'complete set of financial statements of a small entity' in Section 1A. Further guidance could then be provided to explain how a small entity, depending on its individual circumstances, may also wish to consider the statements in Section 6 for the purpose of the financial statements giving a true and fair view.
18. Proposed paragraph 1A.8(d) appears to suggest that, when a small entity takes up the option to adapt the balance sheet format, any item recognised in other comprehensive income (OCI) needs to be presented separately in equity. We believe this should be redrafted to make clear that it is only when it is required by FRS 102 that an item of OCI *must* be presented separately in equity.
19. Proposed paragraph 1A.14(v) sets out the disclosure requirements for related party transactions that 'have not been concluded under normal market conditions.' We believe that, in line with our suggestions above, this is the type of legal requirement where the FRC could provide further guidance. For example, it could clarify that by disclosing *all* related party transactions a small entity will not be in breach of the law, consistent with the conclusion reached by the Accounting Regulatory Committee in 2007 and noted in paragraph 36 of Appendix IV of FRS 8 (2008 version). Also, in line with the comments made above in paragraph 14, we believe it would be useful for the FRC to set out the underlying legal requirement in full using the same wording used in the Companies Act. However, should the FRC decide not to use the same wording, we would at the very least recommend that the word 'material' (as used in the Companies Act) is introduced in this paragraph.

Other matters

20. We considered whether the FRC should also produce a separate standalone version of FRS 102 for entities applying the small companies regime. There may well be interest in such a document. However, we acknowledge that it could not, as a result of the restrictions in the law, be truly a 'one-stop shop' as is the case with the current FRSSE. That is, the disclosure requirements would be limited to those that can be mandated by law, but the requirement to ensure that the financial statements are true and fair would more often than not result in references being made to the full version of FRS 102. For the moment, we believe that the FRC should focus on ensuring that Section 1A is as easy to use and coherent as possible, while staying alert to any calls for a separate document.
21. In light of the items identified including our concerns over the structure and layout of Section 1A, we recommend that the FRC issues a fatal flaw draft of revised FRS 102 shortly before it is finalised (perhaps 1-2 weeks in advance). This will enable the FRC and stakeholders to consider the changes within the context of the whole standard while also providing an opportunity to iron out any last minute inconsistencies or issues.

Question 2:

In developing these proposals the FRC has applied the principle that there should not be differences between the recognition and measurement requirements applicable to small entities and those applicable to larger entities. This principle has been determined after taking account of the generally positive response to a similar proposal in the Consultation Document. Do you agree with this principle? If not, why not and what alternative principle or specific exceptions to the principle would you propose?

22. During our discussions on the 2014 FRC consultation paper *Accounting standards for small entities: implementation of the EU Accounting Directive*, we highlighted concerns over the lack of accounting simplifications to FRS 102 available to small entities, particularly in relation to financial instruments. However, after extensive outreach with members, we reached the conclusion that there was not, on balance, a compelling case for providing accounting simplifications to FRS 102 for small entities. Our principal reasons for this were that:
- FRS 102 draws a distinction between basic and non-basic financial instruments. It is likely in practice that the majority of financial instruments used by small entities will fall into the basic category (and will therefore, in most cases, be recognised at amortised cost).
 - Reflecting the value of complex arrangements (such as complex financial instruments) in the financial statements should help to ensure that directors fully understand the nature of the products and the associated risks. This is underlined by the widespread mis-selling in recent years of financial instruments such as non-vanilla interest rate swaps.
 - The implementation of the new EU Accounting Directive in the UK means that the small company accounting thresholds will increase. As a result, much 'larger' entities of some economic significance will soon qualify as 'small' and it is not necessarily appropriate to permit simplified accounting for these entities. In our view, it is difficult to identify simplifications that would be appropriate for all of the broad and growing range of entities qualifying as 'small'. On the other hand, the great majority of UK small companies qualify for the optional micro-entities regime, which excludes the use of fair value accounting entirely.
23. We therefore broadly agree with the decision not to introduce any simplifications to the recognition and measurements requirements of FRS 102 for small entities, although as noted in question 3 below, we consider there to be scope for some further transitional provisions. We also continue to believe that amendments should not simply be ruled out in principle if specific issues are identified, particularly in relation to certain types of financial instruments. The FRC

should be prepared to reconsider on a case by case basis the merits of suggestions from constituents for simplification in particular areas, both now and in future. In addition, the FRC should continue to monitor very closely whether the dividing line between basic and non-basic financial instruments has been drawn in the right place, not just in relation to small entities but all FRS 102 reporters. This process of post-implementation review should be an active one undertaken in close collaboration with stakeholders, not one delayed until the first triennial review.

24. Cost:benefit considerations and the importance of a smooth and orderly transition should loom large in this process. The FRC should also monitor whether the application of the FRS 102 requirements for accounting for financial instruments by small entities meets expectations and consider what more needs to be done if this is not the case.

Question 3:

Do you agree that the transitional provisions in FRS 102 are sufficient for small entities, or have you identified any further areas where transitional provisions should be considered? If so, please provide details.

25. In general we believe that the transitional provisions in FRS 102 will be sufficient for small entities, although there may be scope for a further transitional provision in relation to derivative financial instruments. That is, where a derivative financial instrument no longer exists at the balance sheet date (of the first set of financial statements prepared under FRS 102), it might be useful to provide an optional exemption from the requirement to restate the comparative figures for the transaction, although with disclosure encouraged. We also understand that there may be some specific transitional issues affecting small agricultural entities moving to FRS 102. ICAEW would be happy to facilitate further discussions in relation to these issues,
26. We do still have concerns about the length of time that small entities will have to prepare for transition, particularly when the final revised version of FRS 102 is not expected to be ready for issue until summer 2015, at which point the date of transition will have passed for the majority of small entities. The opportunity to obtain important information at the date of transition and during the comparative period may be lost due to this very tight deadline. It is therefore important for the FRC to issue the revised standard, with carefully considered transitional provisions, allowing for the tight timing, at the earliest possible date.
27. It will also be incumbent on regulators, professional bodies, training organisations and practitioners to make concerted efforts to ensure that small entities are sufficiently prepared for transition, including the accounting for new and complex areas of accounting such as financial instruments. However, as already noted, the opportunity to provide timely advice to small entities will be restricted in practice by the tight implementation deadline.

Question 4:

Do you agree with the other amendments proposed to FRS 102 for compliance with company law? If not, why not?

28. We broadly agree with the other proposed amendments to FRS 102, required to ensure compliance with changes to company law arising from the new Directive. However, we considered each section in turn and have identified a number of specific issues which are set out in the Appendix 2 to this letter.

Question 5:

This FRED is accompanied by a Consultation Stage Impact Assessment. Do you have any comments on the costs or benefits discussed in that assessment?

29. We welcome the Consultation Stage Impact Assessment performed by FRC and broadly agree with the benefits that have been identified in relation to proposal to bring small entities within the scope of FRS 102. In particular, reduced training costs over the long-term, improved

comparability between different-sized entities and an easier transition in accounting terms as businesses grow.

- 30.** There will of course be costs associated with the new regime, for example, new software and some up-front training costs. These should not be under-estimated. In addition, the interaction between the changes to UK company law and the revised financial reporting regime is likely to represent a significant challenge for some entities and may increase the costs and efforts associated with accounts preparation. Although much of the complexity originates from the underlying new legal requirements, and is therefore outside the control of the FRC, it does demonstrate the importance of ensuring that Section 1A is abundantly clear and accessible for users.

APPENDIX 1

Suggested layout for minimum disclosure requirements in Section 1A

1A.14 As a minimum, where relevant to its transactions, other events and conditions, a small entity shall provide the following disclosures:

(A) Accounting policies

(A.1) Accounting policies

Sch1, Part 3, paragraph 44

The accounting policies adopted by the company in determining the amounts to be included in respect of items shown in the balance sheet and in determining the profit or loss of the company must be stated (including such policies with respect to the depreciation and diminution in value of assets)

Paragraphs 8.5 and 8.6 will help entities meet this disclosure requirement.

Paragraphs 10.13 and 10.14 will help when there has been a change in accounting policy.

(A.2) Development costs

Sch1, Part 2, paragraph 21 (2)

If any amount is included in a company's balance sheet in respect of development costs, the note on accounting policies (see paragraph 44 of this Schedule) must include the following information:

- (a) the period over which the amount of those costs originally capitalised is being or is to be written off, and**
- (b) the reasons for capitalising the development costs in question**

An intangible asset arising from development (or from the development phase of an internal project) can be recognised if, and only if, an entity can demonstrate all the criteria set out in paragraph 18.8H.

(A.2) Intangible assets

Sch1, Part 2, paragraph 22 (4)

There must be disclosed in a note to the accounts the period referred to in subparagraph (2) [*the useful life of intangible assets*] and the reasons for choosing that period.

Paragraphs 18.27(a) and 19.25(g) will help with the information required to explain the period over which intangible assets (including goodwill) are written off.

Etc....

The proposed layout outlined above is representative only and does not include all possible legal requirements which might be included under the heading of Accounting Policies.

APPENDIX 2

Other matters

We have reviewed each section of FRS 102 and noted a number of specific matters as outlined below:

Section 1 Scope

1. It is not clear which version of which accounting standard an entity should apply depending on whether or not it is choosing to early adopt the changes in UK company law. The FRC should make this abundantly clear when finalising the standards. It may for example be helpful to amend the titles of each version of FRS 102 to state the accounting periods to which they apply.
2. Our understanding is that an entity choosing to early adopt the changes in UK company law would apply the revised version of FRS 102 (eg, the version updated for changes to company law and including Section 1A). Therefore, a small entity choosing to early adopt the revised small companies regime in 2015 (including an entity qualifying as small for the first time under the revised thresholds) would not be permitted to apply FRSSE 2015. Instead, it would apply revised FRS 102.

Section 4 Statement of Financial Position and Section 5 Statement of Comprehensive Income and Income Statements

3. Changes to UK company law will allow greater flexibility in the balance sheet and profit and loss account formats. We understand that the main objective of this change is to enable the use of IFRS terminology and believe it would be helpful for the FRC to clarify this point in Sections 4 and 5. It would also be useful for the FRC to clarify whether an entity choosing to adapt its balance sheet or profit and loss account in accordance with *The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015*, is required to use the terminology as outlined in proposed paragraphs 4.2A to 4.2B and 5.5B to 5.7A.
4. We also strongly recommend that the FRC liaise closely with Companies House regarding the new flexibility in the terminology and formats to avoid financial statements prepared under the revised framework being incorrectly rejected.

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

5. As noted in our response to question 1, we do not believe that the proposed amendments to FRS 102 sufficiently explain the interaction between the restriction on information that can be required by law in small company accounts together with the requirement for those accounts to show a true and fair view. We believe the need for clarity on this matter extends across all sections of FRS 102. For example, proposed paragraph 6.1A could be improved with some minor redrafting:

By law a small entity is not required to comply with this section. Presentation requirements for small entities are set out in Section 1A Small Entities. However, Paragraph 1A.4 encourages a small entity to present a statement of changes in equity.

Section 9 Consolidated and Separate Financial Statements

6. In our view the FRC should, as far as possible, use the same wording as set out in the Companies Act, and then if necessary add further explanatory text. Otherwise, there is a risk of error or confusion as noted in the following examples:

- The proposed amendments to paragraph 9.3 (b) and (d) should read ‘90% owned or more...’
 - The word ‘equity’ in proposed paragraphs 9.3 (bA) and (dA) should read ‘allotted shares’
 - Proposed paragraph 9.3 (e) should read ‘The parent and the group headed by it..’
 - It could be made clearer that sub-paragraphs 9.3 (b) and (bA) relate to subparagraph 9.3 (a), and equally that sub-paragraphs 9.3 (d) and (dA) relate to sub-paragraph 9.3 (c).
7. Also, we understand the proposed new sentence in paragraph 9.3 (e) is intended to reflect the change to UK company law which allows a company to be exempt from the requirement to prepare group accounts if it would have been subject to the small companies regime but for being a public company, and is not a traded company. However, we find the proposed wording extremely unclear and do not believe it will be understood.

Section 11 Basic Financial Instruments

8. It is not clear to us why the FRC has chosen to amend several of the examples in this section, rather than simply adding further ones. We are concerned that this might give the impression that either the previous examples were incorrect or that the requirements have changed, neither of which is the case.

Section 21 Provisions and Contingencies

9. It has been proposed that paragraph 21.17 regarding prejudicial disclosures should be deleted. However, we do not believe that this is required by the new Directive and strongly believe that it should therefore be reinstated. We also suggest that the phrase ‘unless its disclosure is required by law’ which appears in FRS 12.97 should be introduced into this paragraph.

Section 34 Specialised Activities

10. The proposed amendments to Section 34 only serve to increase the confusion regarding merger accounting for Public Benefit Entities (PBEs). We understand that the amendments are driven by the fact that the changes to UK company law now permit merger accounting only for group reconstructions. However, we feel FRS102 must allow for PBEs of all kinds, not just those structured as companies, and so far as possible ensure they account for similar transactions in the same way. For public benefit entity combinations that meet the criteria of a merger, it might be simpler if a company which does enter into such a combination simply applies the true and fair override.
11. Notwithstanding our comments on the proposed amendments on public benefit entity combinations, we generally find the drafting of Section 34 to be unhelpful, in particular paragraphs PBE34.77 to PBE34.79 on combinations that are in substance a gift. For example, paragraph PBE34.77 states that: ‘A combination that is in substance a gift shall be accounted for in accordance with Section 19 except for the matters addressed in paragraphs PBE34.78 and PBE34.79 below.’ However, in Section 19, for a merger which is in substance a gift, paragraph 19.6(b) simply refers the reader back to Section 34.
12. On a final note, we would highlight that in future many charity mergers may involve charitable incorporated organisations (CIOs) using the provisions in sections 235-244 of the Charities Act 2011 allowing the transfer and amalgamation of CIOs into other CIOs without loss of legal personality (with the property, assets and liabilities being transferred automatically). Equivalent provisions exist for SCIOs under the Charities and Trustee Investment (Scotland) Act 2005. While these provisions do not specify any specific accounting treatment, it would be helpful for FRS102 to use terminology in respect of PBE combinations which clearly allows for such transfers and amalgamations.

Glossary

- 13.** For the non-current asset definition in paragraph 62: the 'nor' preceding bullet (d) should be replaced with 'or'; and the final sentence (d) should read 'are cash or cash equivalents ~~unless the assets are~~ restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.'

Legal requirements

- 14.** In light of the issues noted above in relation to Section 9, we believe it would be beneficial for the FRC to check that the legal requirements are accurately reflected in Appendix IV to FRS 102. The FRC should, as far as possible, aim to use the same wording as that employed in the Companies Act, deviating only when absolutely necessary.

Accounting Council's Advice

- 15.** Although not specifically addressed as a consultation question, we note that the Accounting Council's Advice to the FRC to issue FRED 59, covers Residential Management Companies. This advice is replicated in FRED 58 Draft FRS 105 *The Financial Standard applicable to the Micro-entities Regime*, together with a specific consultation question.
- 16.** As this topic raises a number of issues not strictly relevant to the detailed discussion on FRS 102 (or draft FRS 105), ICAEW will provide the FRC with comments in a separate representation letter. However, we would like to point out, at this stage, that we are not convinced that the 'clear statement of the legal position' provided by the Accounting Council is accurate and recommend that this is reviewed carefully by the FRC.