Financial Reporting Council

February 2015

Consultation Overview: FREDs 58, 59 and 60

Implementation of the EU Accounting Directive

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

1 Introduction

1.1 As a consequence of the expected changes to company law arising from the implementation of the EU Accounting Directive, it is necessary to make amendments to UK and Republic of Ireland (RoI) accounting standards to ensure continued consistency between the revised legal frameworks and the financial reporting framework. This has also given the FRC the opportunity to reconsider the most appropriate way that accounting standards can support the new micro-entities regime.

1.2 The changes to company law predominantly affect the small companies regime, however other more minor amendments will affect other aspects of UK and Republic of Ireland accounting standards.

1.3 In September 2014, the FRC issued a consultation document *Accounting standards for small entities – Implementation of the EU Accounting Directive*[1] which set out a high-level overview of the proposed changes to the UK and RoI financial reporting framework. In general, there was strong support for the proposals made.

1.4 This document accompanies the following suite of financial reporting exposure drafts (FREDs) where respondents can find the consultation questions and provides stakeholders with an overview of the proposed new financial reporting framework:

(a) FRED 58 *Draft FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime*;

(b) 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*; and

(c) FRED 60 *Draft amendments to FRS 100 Application of Financial Reporting Requirements and FRS 101 Reduced Disclosure Framework.*

1.5 The consultation has been presented in three FREDs to distinguish between the different standards affected by the proposals. A brief summary of each FRED is included below. Respondents should refer to the relevant FRED for more detailed information on the amendments proposed.

1.6 This document has primarily been drafted from the perspective of a smaller company incorporated under the Companies Act 2006[2], as these are the entities that are most likely to be affected by the changes. It focuses on the overall financial reporting framework, the eligibility criteria for each regime within the new framework and the related accounting standards available.

FRED 58 *Draft FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime*

1.7 FRED 58 sets out a proposed new standard to support the introduction of the micro-entities regime into UK company law in November 2013. 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 *Consultation on the*

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[1] The Consultation Document and responses can be accessed here: https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Consultation-Document-Accounting-standards-for-sma.aspx

[2] The Companies (Amendment) Act 1986 is the current Irish equivalent. However, in Ireland the Companies Bill 2012 was signed by the President on 23 December 2014 and has been enacted as the Companies Act 2014 (Act Number 38 of 2014). The Act is expected to be commenced substantially by a Statutory Instrument with effect from 1 June 2015. The Companies Act 2014 consolidates 17 Acts, including the Companies (Amendment) Act 1986 and 15 Statutory Instruments.

transposition of the EU Accounting Directive 2013/34/E. If the regime is introduced in the RoI, draft FRS 105 will be applicable.

1.8 The regime has strict qualifying criteria and is currently only available to companies.

1.9 Draft FRS 105 is based on the recognition and measurement requirements of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* so that all new UK GAAP standards are based on a consistent framework. However, consideration has been given to the size and complexity of companies that will qualify for this regime and appropriate further simplifications have been proposed.

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*

1.10 It is proposed that the Financial Reporting Standard for Smaller Entities (FRSSE) is withdrawn and replaced with a new section of FRS 102 developed specifically for small entities. FRED 59 sets out this proposed new section, Section 1A *Small Entities*.

1.11 Section 1A proposes that small entities will apply the recognition and measurement requirements of FRS 102, but different presentation and disclosure requirements, thus ensuring that all entities reporting under new UK GAAP apply a consistent framework.

1.12 In addition, other more minor amendments are required to FRS 102 to ensure continued compliance with changes to company law. FRED 59 also sets out these proposed amendments.

FRED 60 *Draft amendments to FRS 100 Application of Financial Reporting Requirements and FRS 101 Reduced Disclosure Framework*

1.13 Minor amendments are also required to FRS 100 *Application of Financial Reporting Requirements* and FRS 101 *Reduced Disclosure Framework* to ensure continued compliance with changes to company law. FRED 60 sets out these proposed amendments.

1.14 The most significant amendment to FRS 101 provides greater flexibility in relation to the format of the profit and loss account and balance sheet, allowing the use of IFRS-based presentation requirements similar to those used for the group accounts.

Submitting comments

1.15 The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the FREDs but questions relating specifically to issues pertinent to a particular FRED are set out towards the beginning of that document.

1.16 Responses to the FREDs should be despatched so as to be received no later than **30 April 2015**. Information on how to submit comments and the FRC's policy in relation to responses is set out at the back of each FRED.

2 The new financial reporting framework

2.1 Company law recognises two financial reporting frameworks – IFRS and UK GAAP (generally accepted accounting practice).

2.2 Publicly listed companies are required to apply IFRS to the preparation of their group accounts but may choose between IFRS and UK GAAP for the preparation of their individual parent accounts. Other entities have a free choice between the two frameworks.

UK GAAP

2.3 The proposed new UK GAAP reporting framework will be made up of five regimes compared to only two under the old reporting framework.

2.4 Under the old reporting framework, smaller entities had a choice between two core UK GAAP regimes:

- the small entities regime applying the Financial Reporting Standard for Smaller Entities (the FRSSE); and
- full UK GAAP (applying SSAPs, FRSs and Interpretations).

2.5 Under the new reporting framework, the FRSSE will be withdrawn and smaller entities will now have to choose between three core UK GAAP regimes subject to meeting relevant criteria:

- the micro-entities regime (draft FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*);
- the small entities regime (Section 1A *Small Entities* of FRS 102); and
- FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

Table 1: UK GAAP

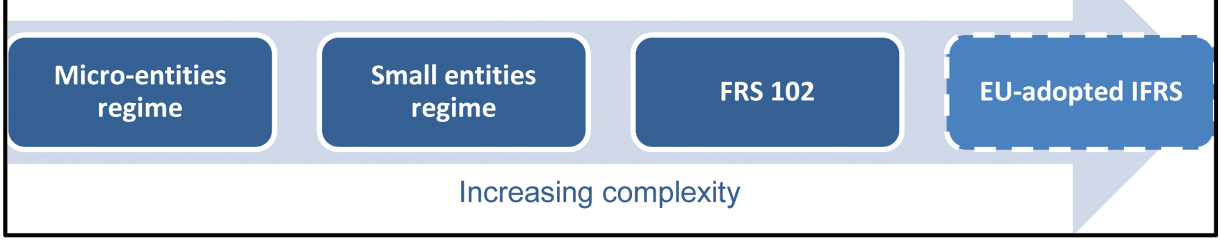
Old framework	**Small entities regime**		**Full UK GAAP**	**N/a**	**N/a**
New framework	**Micro-entities regime**	**Small entities regime**	**FRS 102**	**Reduced disclosure framework (FRS 101)**	**Reduced disclosures for subsidiaries and ultimate parents (FRS 102)**
Related accounting standard(s)	Draft FRS 105	Draft Section 1A *Small Entities* of FRS 102	FRS 102	FRS 101	Paragraphs 1.8 to 1.13 of FRS 102

2.6 Entities that are part of a group may apply either of the reduced disclosure regimes. These additional options are discussed in more detail in Section 4 *Additional options for entities that are part of a group*.

The new core UK GAAP regimes

2.7 The financial reporting requirements of each standard get progressively more complex and comprehensive the further up the suite of standards you go. The increase in complexity correlates to the increasing size and complexity of the entities that are most likely to apply a given standard. In all cases, an entity may choose to opt up to a more comprehensive regime.

Diagram 1



2.8 The selection of which regime to apply will depend on a number of factors including the following:

- Whether an entity is eligible to apply that particular regime. Eligibility criteria may include the type of financial statements (ie individual or group) being prepared, company size thresholds and entity type.
- Where a choice of regime exists, entities should consider which of the regimes is the most appropriate to the individual circumstances of an entity. Factors to consider will differ from company to company and may relate to certain characteristics or restrictions of a particular regime, the resources available and the information needs of users of the accounts, amongst many others.

2.9 The following table outlines the key eligibility criteria for the micro-entities and small entities regimes. Entities should refer to the detailed eligibility criteria in the relevant legislation in order to determine if they are eligible or not.

Table 2: Eligibility criteria

Regime	Micro-entities regime	Small entities regime[3]
Source of eligibility criteria	Sections 384A to 384B of the Companies Act 2006.	Sections 382 to 384 of the Companies Act 2006.
Eligible entities	• Companies only (Note: Whilst the legislation and consequently draft FRS 105 uses the term micro-entities regime, it is only currently available under law to companies.)	• Companies • Limited liability partnerships[4] • Any other type of entity that would have met the criteria of the small companies regime had it been a company incorporated under company law (for example charities)

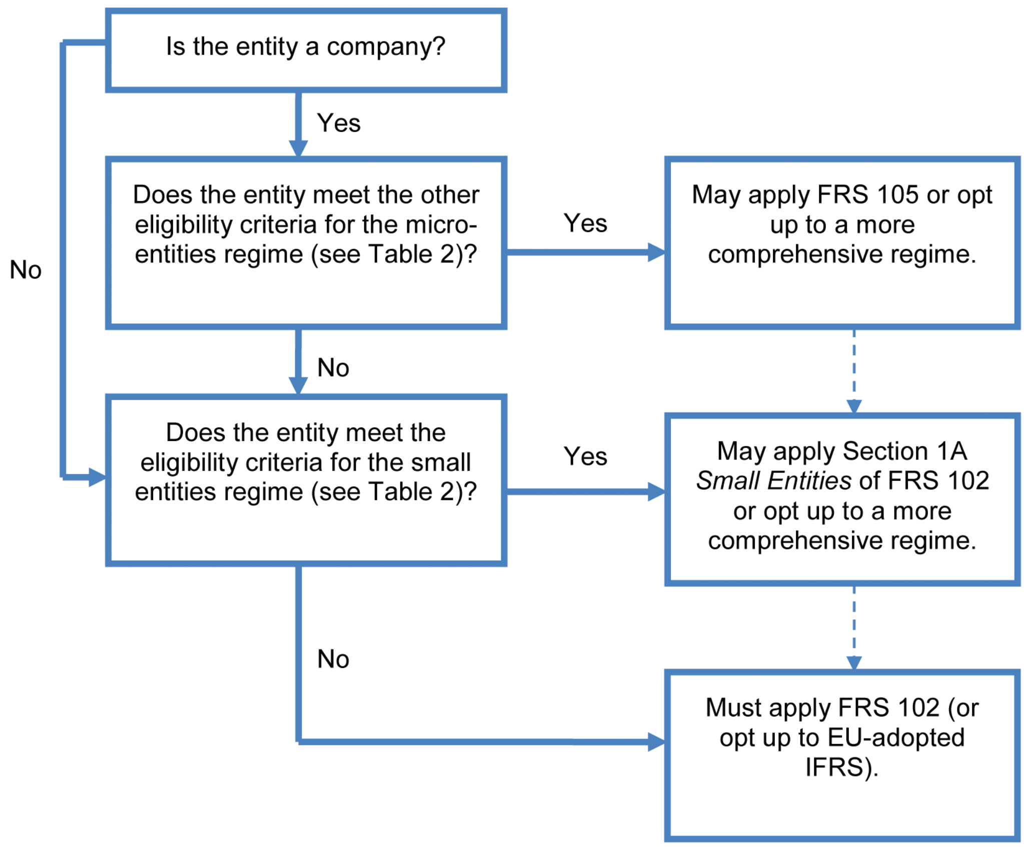
3 For Irish entities, small companies are referred to in Section 8 of The Companies (Amendment) Act 1986. The current equivalent size criteria are: Turnover not exceeding €8.8m, Balance Sheet total not exceeding €4.4m, and number of employees not exceeding 50. Please refer to footnote 2 for information regarding the new Combined Companies Act 2014 which will have effect from 1 June 2014.

4 As set out in the *Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008* (SI 2008/1913).

Regime	Micro-entities regime	Small entities regime
Size thresholds	A company qualifies if it does not exceed two or more of the following criteria: • Turnover £632,000 • Balance sheet total £312,000 • No. of employees 10	A company qualifies if it does not exceed two or more of the following criteria: • Turnover £10.2m • Balance sheet total £5.1m • No. of employees 50
Ineligible entities	• Any companies excluded from the small companies regime • Financial institutions including credit and insurance institutions • Charities • Small parent companies that choose to prepare group accounts • Companies that are not parent companies but their accounts are included in consolidated accounts	• Public companies • Financial institutions including insurance companies and banking companies

2.10 The following decision tree will help an entity identify the options that may be open to it in selecting its reporting regime:

Diagram 2: Decision tree



3 Key features of the new core UK GAAP regimes

FRS 102

3.1 FRS 102 was first issued in March 2013 and revised in August 2014, and is effective for accounting periods beginning on or after 1 January 2015.

3.2 FRS 102 replaces over 70 accounting standards and UITF interpretations spanning more than 2,400 pages, with one succinct standard of a little over 300 pages. It reflects developments in the way businesses operate and uses up-to-date accounting treatment and language. One of the key improvements in financial reporting is that FRS 102 requires the recognition of financial instruments and disclosure of the risks associated with those instruments. It also improves intellectual mobility and reduces the costs of education and training.

3.3 Since the publication of FRS 102, the FRC has engaged with stakeholders and responded to a number of issues that have been raised. This has resulted in the publication of amendments to FRS 102 (in July 2014 before the standard's effective date) in relation to two financial instruments issues:

- the classification between "basic" and "other"; and
- hedge accounting.

3.4 In addition, the FRC has issued a number of clarification statements and editorial amendments on more minor issues. These can be found on the FRC website[5].

3.5 For convenience, a revised edition of FRS 102 was published in August 2014[6] which incorporates the amendments noted above in relation to financial instruments and the editorial amendments issued to date.

The micro-entities regime (FRED 58)

3.6 Micro-entities are the smallest of entities (with turnover of up to £632,000) and a subset of the small entities regime. The proposed accounting standard for micro-entities, draft FRS 105, has been developed around the legal framework from the requirements of FRS 102.

3.7 FRS 102 has been amended to reflect the micro-entities regime as set out in company law as well as further simplifications to accounting treatment that are considered appropriate for entities of this size.

3.8 Although draft FRS 105 is the least complex standard, every entity that is eligible to apply it should consider whether the regime meets their individual needs. It is important to remember that the micro-entities regime is optional even if an entity meets the eligibility criteria.

3.9 The micro-entities regime requires limited disclosures and constrains the accounting policies that can be applied:

- The only primary statements required are a balance sheet and profit and loss account. There is no requirement to prepare a cash flow statement or statement of recognised gains or losses. Further, the information presented in the balance sheet and profit and loss account is condensed (for example "fixed assets" is not

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5 https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-Editorial-amendments-and-clarification.pdf

6 https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-appli-(1).pdf

disaggregated into tangible fixed assets, intangible assets, investment properties etc).

- No assets can be measured at fair value or a revalued amount. This means that land and buildings and investment properties can only be measured at cost and previous revaluations gains would need to be removed on transition.
- Micro-entities' accounts are **only** required to disclose the following:
  - the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet;
  - an indication of the nature and form of any valuable security which has been provided;
  - the amounts of advances and credits granted to members of the administrative, managerial and supervisory bodies with indications of interest rates, main conditions and any amounts repaid or written off or waived; and
  - any commitments entered into on their behalf by way of guarantees of any kind, with an indication of the total for each category.

  However, there is no restriction on micro-entities disclosing more information voluntarily.
- Micro-entities' accounts that comply with the minimal legal requirements are presumed to give a true and fair view. There is no requirement for directors to consider what additional information may be needed in order for the accounts to give a true and fair view.

3.10 In addition to these legal constraints, it is proposed that draft FRS 105 is simplified further, for example:

- there is no requirement to account for deferred tax and equity-settled share-based payments; and
- all accounting policies choices have been removed, including the options to capitalise development costs and borrowing costs.

More detailed discussions of the additional simplifications can be found in FRED 58.

Comparison to the FRSSE

3.11 For entities currently applying the FRSSE, Appendix 1 to this document sets out the key differences between that standard and draft FRS 105. In the majority of instances, the accounting treatment of draft FRS 105 is either simpler or the same as that of the FRSSE.

The small entities regime (FRED 59)

3.12 It is proposed that the thresholds for the small entities regime will increase resulting in more entities qualifying as small.

3.13 Similarly to draft FRS 105, the proposed section of FRS 102 relating to small entities (draft Section 1A of FRS 102) has been developed around the new legal framework from the requirements of FRS 102.

3.14 The requirements of the small entities regime are more comprehensive than the micro-entities regime and it is proposed that the recognition and measurement requirements of Section 1A are the same as those set out in the rest of FRS 102. Two key differences between the small entities regime and the micro-entities regime are that the use of fair value and revaluation accounting is permitted and that more transactions will be accounted for, including deferred tax and equity-share based payments.

3.15 The law only mandates a limited number of specified disclosures. However, unlike the micro-entities regime, directors of small entities are legally obligated to prepare accounts that give a true and fair view whereas micro-entity accounts are automatically presumed to give a true and fair view if the legal minimum is adhered to. In practical terms this will require more work of directors of small entities in considering what additional information (if any) is needed to ensure the accounts give a true and fair view. Draft Section 1A of FRS 102 provides additional guidance to assist directors.

3.16 The small entities regime is discussed in more detail in FRED 59.

Comparison to the FRSSE

3.17 For entities currently applying the FRSSE, Appendix 2 to this document sets out the key differences between that standard and draft Section 1A of FRS 102. In the main, the requirements of draft Section 1A and the FRSSE are the same. However, there are a handful of key differences in accounting treatment between the two standards worth noting, including the recognition of additional financial instruments such as derivatives like interest rate swaps and foreign exchange contracts.

4 Additional options for entities that are part of a group

4.1 For entities that are part of a group and included in the consolidated financial statements (known as qualifying entities), UK GAAP provides an additional two further reporting regimes. Both regimes aim to make group reporting more efficient and cost effective by permitting consistent accounting policies to be applied across a group, but with reduced disclosures.

Table 3: Eligibility criteria		
Regime	**Reduced disclosure framework (FRS 101)**	**Reduced disclosures for subsidiaries and ultimate parents (FRS 102)**
Source of eligibility criteria	Definition of a qualifying entity as set out in the glossary to FRS 101.	Definition of a qualifying entity as set out in the glossary to FRS 102.
Eligible entities	A member of a group: • where the parent prepares publicly available consolidated financial statements which are intended to give a true and fair view; and • that is included in the consolidation	A member of a group: • where the parent prepares publicly available consolidated financial statements which are intended to give a true and fair view; and • that is included in the consolidation
Size thresholds	None	None
Ineligible entities	Charities	None

4.2 Each regime is based on a different underlying reporting framework:

- FRS 101 *Reduced Disclosure Framework* is based on EU-adopted IFRS; whereas
- the reduced disclosures for subsidiaries and ultimate parents in FRS 102 is based on FRS 102.

4.3 In essence, entities applying either reduced disclosure regime are required to otherwise apply the underlying requirements of the related standard (ie EU-adopted IFRS or FRS 102) but are permitted to take advantage of certain disclosure exemptions.

4.4 Both reduced disclosure regimes are optional.

Appendix 1
Key differences between draft FRS 105 and the FRSSE

A more detailed analysis of the differences between draft FRS 105 and the FRSSE will be available on the FRC website.

Table 4: Key differences comparing draft FRS 105 to the FRSSE	
Key features of draft FRS 105:	
Presumed true and fair view	Financial statements prepared in accordance with the legal requirements of the micro-entities regime are presumed to give a true and fair view, therefore directors are not required to consider what additional information is required for the financial statements of the entity to give a true and fair view. This is in contrast to the FRSSE where directors are legally obligated to ensure the financial statements provide a true and fair view.
Preparation of only two primary statements required	Micro-entities are only required to prepare a balance sheet and profit and loss account and not a statement of recognised gains and losses (STRGL) or a cash flow statement.
Significantly condensed formats of statements	The statutory formats for the balance sheet and profit and loss accounts are significantly condensed, for example "current assets" is not disaggregated into stocks, debtors, investments and cash.
Significantly reduced number of disclosures	Micro-entities are only legally required to provide two disclosures, and are not required to provide any more. However, micro-entities can voluntarily provide more disclosures. This is in contrast to the FRSSE which mandates significantly more disclosures.
Simplified accounting treatment	Draft FRS 105 has simplified the accounting treatment for some transactions, for example there is no requirement to account for deferred tax or equity-settled share-based payments.
Fair value and revaluation accounting not permitted	Micro-entities are not permitted to fair value or revalue any assets or liabilities, therefore all assets and liabilities (such as land and buildings and investment properties) must be held at cost. This is in contrast to the FRSSE which permits certain assets to be revalued.
No accounting policy choices	All accounting policy options have been removed. The mandatory treatments result in earlier recognition of income / expenses in the profit and loss account rather than deferring into the balance sheet. Therefore government grants must be accounted for using the performance, not accruals, method.
More helpful guidance included	In many instances, the requirements of draft FRS 105 do not differ from those of the FRSSE, however more guidance is provided in FRS 105 to help preparers apply and interpret the treatment required.
Not all company law requirements are reproduced	Draft FRS 105 does not reproduce all the reporting requirements from company law applicable to micro-entities unlike the FRSSE, but does incorporate those relating to the financial statements. Micro-entities will need to satisfy themselves that they have met all their legal requirements.
Terminology used consistent with FRS 102	Draft FRS 105 uses terminology consistent with FRS 102 such as 'statement of financial position' rather than 'balance sheet'. A table of equivalence is included in Appendix II to draft FRS 105 for convenience.

Appendix 2
Key differences between draft Section 1A *Small Entities* of FRS 102 and the FRSSE

A more detailed analysis of the differences between draft Section 1A of FRS 102 and the FRSSE will be available on the FRC website.

Table 5: Key differences between draft Section 1A of FRS 102 and the FRSSE	
Key features of draft Section 1A of FRS 102:	
Preparation of only two primary statements required	Small entities are only required to prepare a balance sheet and profit and loss account and not a statement of recognised gains and losses (STRGL) or a cash flow statement.
Reduced number of mandatory disclosures	Small entities are only legally required to provide a limited number of specified disclosures. However, directors of small entities are still required to ensure the financial statements provide a true and fair view and therefore must consider what additional information may be needed to achieve this.
More helpful guidance included	In many instances, the requirements of draft Section 1A of FRS 102 do not differ from those of the FRSSE, however more guidance is provided in FRS 102 to help preparers apply and interpret the treatment required.
Improved reporting for financial instruments	FRS 102 will require recognition of some financial instruments that the FRSSE does not currently require. In particular, small entities will need to recognise derivatives such as options, swaps and forward contracts.
Removal of contract rate accounting for foreign currency transactions	FRS 102 does not permit the use of contract rate accounting in relation to foreign currency transactions and a small entity must apply the hedge accounting requirements of FRS 102 instead if they wish to achieve similar accounting results.
Deferred tax arising on revaluations	FRS 102 requires small entities to recognise deferred tax arising on revaluations of fixed assets.
Addition of the performance method of accounting for government grants	FRS 102 permits an accounting policy choice between the accruals method (the method mandated in the FRSSE) and the performance method in relation to government grants. The performance method is simpler to apply and may lead to earlier recognition of income in the profit and loss account in some circumstances.
Gains / losses on investment properties recognised in profit or loss	FRS 102 requires that gains and losses on investment properties must be recognised in profit or loss, rather than in reserves as currently required by the FRSSE.
Not all company law requirements are reproduced	Section 1A of FRS 102 does not reproduce all the reporting requirements from company law applicable to small entities unlike the FRSSE, but does include those relating to the financial statements. Small entities will need to satisfy themselves that they have met all their legal requirements.
Terminology used consistent with FRS 102	Section 1A of FRS 102 uses terminology consistent with the rest of FRS 102 such as 'statement of financial position' rather than 'balance sheet'. A table of equivalence is included in Appendix II to FRS 102 for convenience.

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