Changes in financial reporting

Big changes for small entities

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The Department for Business, Innovation and Skills (BIS) and the Financial Reporting Council (FRC) have published legislation and accounting standards that will change the face of financial reporting for small entities. In this commentary we provide an overview of the changes and consider the impact for your small entity clients.

EU Accounting Directive

Early in 2015 BIS and the FRC published responses to their autumn 2014 consultations on implementation of the EU Accounting Directive.

This commentary provides an overview of the legislation and accounting standards as they will apply to small entities. The practical implications of FRS 102 have been discussed in previous commentaries available on our new UK GAAP website. The implications considered in these commentaries will now apply to small entities. They include assessing the impact, choosing the most appropriate financial reporting framework, retaining transitional information and thinking about tax and, where relevant, audit consequences.

Micro-entity companies do see significant simplification from FRS 102 recognition and measurement requirements. Whereas legislative changes introduced in 2013 bringing about micro-entities have not been widely applied to date, cheaper accounting compliance being introduced by FRS 105 may jump-start the micro-entities' regime going forward. We consider this further below.

Changes to UK Company Law

Key facts

Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015

- Implements the EU Accounting Directive
- Increases company law accounting exemption size limits
- Mandatorily effective for periods commencing on or after 1 January 2016
- Early adoption permitted for periods commencing on or after 1 January 2015
- Reduces mandatory small company disclosure requirements

Company law size thresholds

The Regulations increase the thresholds for determining the size of small and medium companies for accounting exemption purposes.

Company size thresholds – 1 January 2016			
	Micro	Small	Medium
Turnover	£0.632m	£10.2m	£36m
Balance sheet total	£0.316m	£5.1m	£18m
Average employees	10	50	250

Companies will be required to apply the new legislation for financial years commencing on or after 1 January 2016. However, they are permitted to early adopt for financial years commencing on or after 1 January 2015. If they adopt the new legislation to take advantage of increased size limits, they will also need to adopt other provisions of the legislation, (and accounting standards) noted below.

These size limit increases are matched by a consequential increase in audit exemption limits. It should be noted that there are terms within the legislation that prohibit early adoption of the size limits above for audit exemption qualification.

There is also a relaxation to the rule that currently restricts use of accounting exemptions if a company is part of a group which contains a public company (PLC). The rule will change so as to only scope out companies that are part of a group containing a company with securities traded on a regulated market (NB. AIM is not 'regulated' in this context).

Comment

Companies will need to consider carefully whether early adoption of the legislative requirements is the right option for them. With changes to disclosures and accounting standards to consider as well, early adoption may be attractive for some.

With increases to audit exemption limits audit firms may look into other ways of providing proportionate assurance to clients that do not require an audit.

Small company accounts disclosures

Whilst the legislation proposes disclosure changes for companies of all sizes, the most significant changes are for small companies.

For small companies, disclosures are limited by the EU Accounting Directive from which the U.K legislation is transposed. This restricts the ability of the Government, or the FRC (within their accounting standards) to require additional disclosures to those in European Law.

As such, in addition to the directors' report, profit and loss account and balance sheet; small company accounts notes disclosures will extend to:

- accounting policies
- fixed asset movements
- revalued fixed assets
- financial instruments and other assets measured at fair value
- financial commitments, guarantees or contingencies
- security and amounts due after five years
- average number of employees
- advances, credits and guarantees to directors
- related party transactions
- name and registered office of the undertaking drawing up the lowest level of consolidated financial statements in which the entity is included
- items of exceptional size or incidence
- off-balance sheet arrangements
- post balance sheet events.

This will generally lead to a reduction in the information provided in a set of small company accounts.

Comment

It is worth noting that some of the requirements above are less arduous than their current equivalent. For example, related party disclosures are not as extensive. Also, when small entities are moved onto the recognition and measurement requirements of FRS 102 (see below) some of the fair value disclosure requirements become more relevant.

Whether compliance with the reduced legislative disclosures will lead to true and fair accounts presentation is one of the areas considered within the small entities and FRS 102 section below.

Abbreviated accounts out. Abridged accounts in.

Company law currently permits a small company to remove its profit and loss account and directors' report for accounts filed with the registrar. This will continue to be the case under the updated legislation. However, under current legislation, a small company has options to further abbreviate information for filing in the form of 'abbreviated accounts'. This additional abbreviated accounts option is being removed.

Further, the concept of 'abridged accounts' for small companies is introduced. The legislation notes that these would form the full accounts for members, provided they all approve. Abridged accounts, in this context, permit the profit and loss account to start at the 'gross profit or loss' line and also cut down on the analysis otherwise required by law for balance sheet items.

Comment

The removal of traditional abbreviated accounts could lead to more small private company information being available in the public domain; even where the directors' report and profit and loss account are not filed.

Using abridged accounts as a route to filing slightly less information may be an option, though there are multiple other considerations here and the notes requirements (see left) do not disappear.

Other changes

Other headline changes in the legislation include:

- removal of the requirement for micro-entity companies to prepare a directors' report
- additional flexibility on primary statement presentation for all companies
- minor changes to information presented in non-small company accounts
- where the useful life of goodwill cannot be reliably estimated, it will be capped at ten years (this is also changed from five years in the revised FRS 102).

A *new* New UK GAAP framework

Key facts

Amendments to FRS 100 and FRS 101

- Removes FRSSE 2015 and moves small entities onto FRS 102
- Introduces FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime
- Mandatorily effective for periods commencing on or after 1 January 2016

Further changes to the UK financial reporting framework - 2016

The UK financial reporting framework for periods commencing on or after 1 January 2015 (early adoption permitted) remains unchanged. This will see the majority of small companies move onto FRSSE 2015 and non-small companies move onto FRS 102 as shown below.

UK Financial Reporting Framework - 1 January 2015		
As required by legislation / regulation	IFRS	
	Qualifying group entities	FRS 101
Non-small	FRS 102 (August 2014)	
Small	FRSSE 2015	
Micro	FRSSE 2015	

It isn't quite that simple though; as the FRC have removed FRSSE 2015 for periods commencing on or after 1 January 2016, bringing small companies within the scope of FRS 102. Though disclosure requirements will be reduced for small entities, in line with legislative changes noted above, the recognition and measurement requirements are the same as FRS 102. Additionally, a new, simplified financial reporting standard applicable to micro-entity companies is introduced as shown below.

UK Financial Reporting Framework - 1 January 2016		
As required by legislation / regulation	IFRS	
	Qualifying group entities	FRS 101
Non-small	FRS 102 (September 2015)	
Small	FRS 102 (Section 1A)	
Micro	FRS 105	

As is currently the case, an entity may choose to adopt a reporting framework in excess of that required.

The changes for micro-entity and small companies are considered in further detail below. The early adoption of the amended / new standards will only be limited by the application date of applicable legislative requirements. This is also discussed further below.

Comment

With changes to the financial reporting framework exhibiting the behaviour of buses, a sound understanding of what must and may be done at each point in time is essential!

Whilst the changes to size limits and mandatory disclosures in company law are potentially easier to assess, advisors do not have long to consider and advise on the most appropriate accounting standard for an individual client's circumstances. With tax, reported profits, balance sheet position and distributable reserves amongst the considerations, sound advice will be essential.

Micro-entity accounting standard

Key facts

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

- Applies to qualifying micro-entities (companies only) as drafted
- Replaces FRSSE 2015 for micro-entities
- Mandatory for periods commencing on or after 1 January 2016
- Early adoption available
- Significant simplification of FRS 102 recognition and measurement requirements

FRS 105 - Scope and effective date

In 2014, the FRSSE was updated for legislation which permitted qualifying micro-entity companies to prepare and present simplified financial statements. The FRC are proposing additional accounting simplifications for qualifying micro-entities within their draft FRS 105.

As presented FRS 105 only includes within its scope companies that qualify as a micro-entity in law. However the scope is expected to be widened to include LLPs subject to the outcome of a separate government consultation.

Micro-entity company legislation is already in place, therefore FRS 105 is effective, for qualifying entities, from the date of its issue, which was July 2015.

Comment

Whilst micro-entity accounts are rarely seen at present, it isn't hard to imagine the 1.5m micro-entity companies having another look at the option and deciding that the accounting simplification (maybe even with some voluntary additional disclosures) might satisfy their reporting needs.

With micro-entity company requirements already embedded in law, early adoption of FRS 105 may prove popular due to the simplification in recognition and measurement requirements, even when compared to the current FRSSE accounting requirements.

Recognition and measurement simplification

As noted below, from 2016 a small company must apply the recognition and measurement requirements of FRS 102. If the small company also qualifies as a micro-entity it may choose to apply the new FRS 105.

Simplification in FRS 105 may make the regime a more attractive proposition when compared to the equivalent FRS 102 accounting requirements. Key accounting simplifications incorporated in FRS 105 are highlighted below.

Micro-entities cannot, by law, adopt the fair value or alternative accounting rules. This leads to a number of simplifications in FRS 105 that echo those seen when FRSSE was amended to accommodate micro-entities. These include:

- no revaluation of tangible fixed assets or investment properties being permitted
- simplified accounting for financial instruments such as current asset investments.

Whilst the effect of a lack of fair value accounting has little practical effect for most micro-entity companies currently, in a world where the alternative is FRS 102 the effect is more marked. The FRC have decided to include a number of other simplifications when compared to FRS 102. These simplifications are wide ranging, and include:

- simplification of accounting for basic financial instruments including those measured at amortised cost and financing transactions
- removal of fair value and hedge accounting requirements for other financial instruments
- removal of transition options within FRS 102 that refer to fair value (eg. using fair values as a deemed cost on transition)
- prohibition from accounting for deferred tax
- removal of accounting options to capitalise borrowing costs or use the accruals method to account for government grants
- simplification of foreign currency accounting
- removal of requirements to account for equity settled share based payments prior to the issue of shares
- simplification of defined benefit pension plan accounting requirements.

Comment

By introducing significant simplification to many of the tricky areas of FRS 102 accounting, the FRC have offered micro-entity companies a viable and cost-effective reporting route going forward. This could put the so far unpopular micro-entity regime on the map.

Accounts that comply with the limited micro-entity disclosure requirements are deemed to show a true and fair view. However, by setting the bar low in terms of compliance it arguably offers greater flexibility to make additional voluntary disclosure where it is really going to be relevant to the user of the accounts.

Small entities and FRS 102

Key facts

Amendments to FRS 102 - Small entities and other minor amendments

- Brings small entities into the scope of FRS 102
- Amendments mandatory for periods commencing on or after 1 January 2016
- Early adoption available for periods commencing on or after 1 January 2015
- Exempts small entities from a majority of FRS 102 disclosure requirements
- Makes other consequential amendments to FRS 102 arising from legislative changes discussed above

Accounting implications for small entities

FRSSE 2015 applies to small entities for periods commencing on or after 1 January 2015, with changes from the FRSSE 2008 being negligible. For periods commencing on or after 1 January 2016, the mandatory standard for small entities will become FRS 102.

A majority of the amendments sit within a new Section 1A of the standard. Section 1A decreases the mandatory disclosure requirements within FRS 102 for small entities in line with the legislative amendments noted above. There is also reference to the need to prepare accounts that present a true and fair view and, in this context; Section 1A encourages users to consider inclusion of relevant disclosures required elsewhere in the standard.

There are a number of other disclosures that, though not mandatory, the revised standard encourages for small entities. These include:

- inclusion of a statement of comprehensive income and statement of changes in equity, as applicable
- going concern disclosures
- dividends declared and paid or payable
- transition disclosures.

Comment

Under the ‘old’ new UK GAAP, the difficulties and consequences of recognition and measurement differences in FRS 102 were only a problem for larger clients. The broadened scope of FRS 102 in the ‘new’ new UK GAAP presents the same transition questions as for non-small entities - only a year later.

With the date of transition for a 31 December 2016 small client being 31 December 2014 (subject to certain transition exemptions), now is the time to consider the implications of complying with a standard far more complex than the FRSSE.

Many of our earlier commentaries that discuss key differences and the practical implications of FRS 102 are available on our new UK GAAP website.

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