New UK GAAP

ICAEW FINANCIAL REPORTING FACULTY

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Radical changes for small and micro-entities

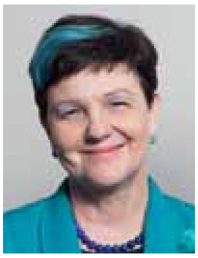
A BRAVE NEW WORLD

A new financial reporting regime for the UK's smallest entities

A FACULTY TECHNICAL PUBLICATION

Growing business

The government is committed to making the UK the best place in the world to start and grow a business. The rigour and integrity of the UK's



financial reporting framework makes a significant contribution to providing a suitable environment for this to happen. Good financial reporting is not just about meeting statutory obligations. It enables business to interact confidently with customers and suppliers, to attract investment, and supports growth. However, if we are to avoid imposing unnecessary burdens on business, reporting obligations must be proportionate, reflecting both the size and nature of a company's business.

A great deal of work has been done recently to provide greater flexibility within the statutory financial reporting framework. This includes, for example, increased thresholds for determining the size of a company, the creation of a light-touch regime for micro-entities, and reduced disclosure requirements for small companies with simple business arrangements. This is complemented by the Financial Reporting Council's latest revisions to accounting standards. While the changes do not fundamentally alter the UK's approach to financial reporting, they provide important opportunities for eligible small businesses, if they wish, to access reporting regimes which are more proportionate to their size and circumstances.

However, change - whatever its purpose - inevitably provides challenges as well as opportunities for business, particularly small businesses. As accountants providing professional advice and services to business, you have a key role to play in ensuring that business owners and managers make effective and - most importantly - well-informed decisions about their future approach to financial reporting.

I hope this publication will provide you with a useful reference point to provide advice to small businesses and help them make the right decision to secure future success.

Lucy Neville-Rolfe

Baroness Neville-Rolfe
Parliamentary Under Secretary of State at the Department for Business, Innovation & Skills

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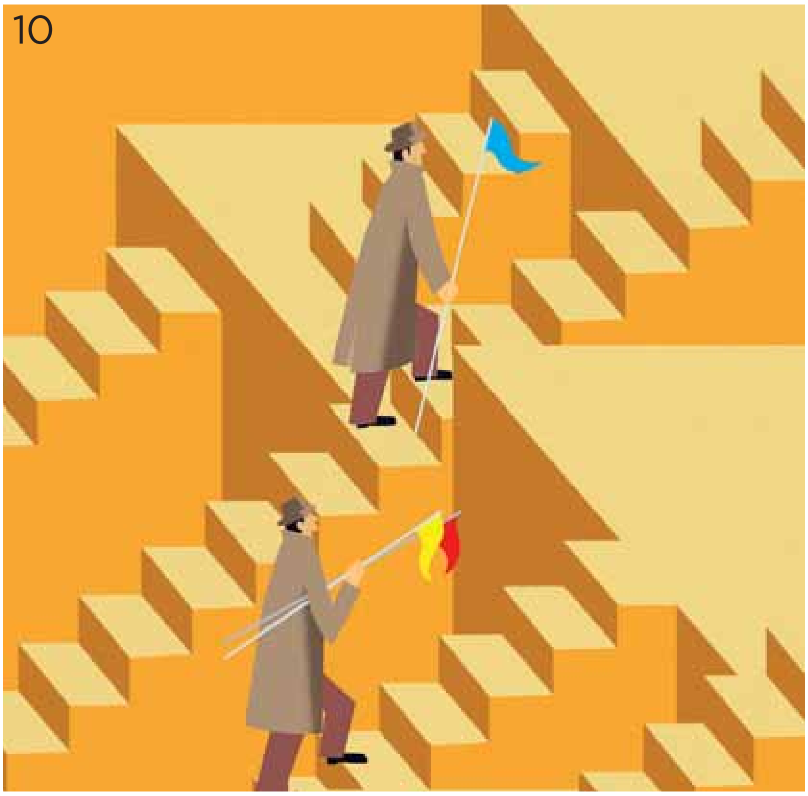

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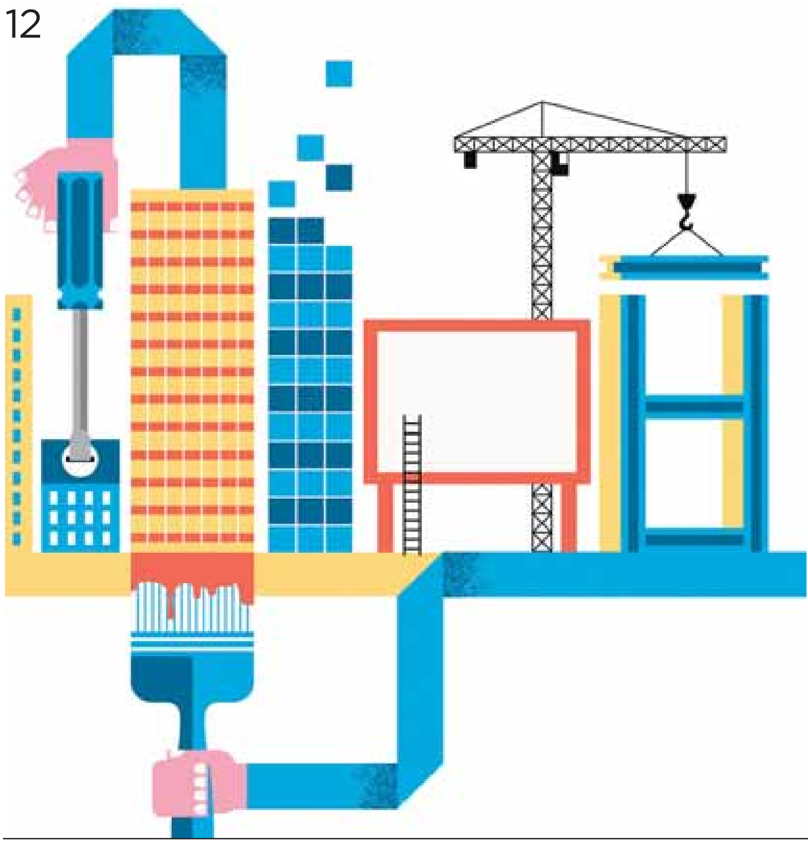


COVER: BEN SANDERS/IKON

The new regime for small and micro-companies: an overview

Nigel Sleigh-Johnson and **Sarah Dunn** consider recent changes to company law applicable to small and micro-entities, the new financial reporting regime for such entities and key factors to bear in mind when reviewing options under the new regime

Last year saw significant changes to the UK accounting regime. SI 2015/980 *The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015* introduced significant changes to UK company law and, in a related move, the Financial Reporting Council (FRC) has:

- withdrawn the Financial Reporting Standard for Smaller Entities (FRSSE);
- published a new standard, FRS 105 *The Financial Reporting Standard applicable to the Micro-Entities' Regime*; and
- published amendments to FRS 102 to bring small companies within its scope.

Further amendments have also been made to the new UK GAAP standards to ensure compliance with the recent changes to company law.

KEY CHANGES TO UK COMPANY LAW

The most significant changes arising from the new regulations relate to the UK small companies regime. These include:

- a revised definition of an 'ineligible group', such that a group is no longer ineligible solely because a public company is a member. This condition has been replaced by a reference to a traded company;
- revised thresholds for small companies and groups, as set out below:

	Company	Group
Turnover	≤ £10.2m	≤ £12.2m
Balance sheet total	≤ £5.1m	≤ £6.1m
Number of employees	≤ 50	≤ 50

- a new option for small companies to prepare 'abridged' accounts;
- fewer available account formats, although there is greater flexibility in terminology and layout;
- limited notes required by law in small company accounts (although those accounts are still required to give a true and fair view);
- withdrawal of the option to file an abbreviated version of the accounts with the Registrar of Companies (although small companies still have the option not to file a copy of the profit and loss account and directors' report); and
- no requirement in future for micro-entities to prepare a directors' report.

These important changes to company law are effective for accounting periods beginning on or after 1 January 2016, with early adoption generally permitted for accounting periods beginning on or after 1 January 2015. However, the increased small company size limits cannot be early adopted in relation to audit exemption.

At the time of writing, the UK government has proposed amendments to the LLP regulations to ensure equivalence with the recent changes to UK company law. The amendments also extend the micro-entities regime to both LLPs and qualifying partnerships. The amended regulations, once in force, will be available for accounting periods beginning on or after 1 January 2016. Early adoption will generally be permitted for accounting periods beginning on or after 1 January 2015.

It is expected that the revised LLP regulations will come into force by May 2016.

THE NEW FINANCIAL REPORTING REGIME FOR SMALL AND MICRO-ENTITIES

Small entities

FRS 102 has been amended to include a new section (Section 1A Small Entities) for companies that qualify for and choose to apply the small companies regime, LLPs eligible for and choosing to apply the small LLPs regime, and any other entity that would have met the criteria for the small companies regime had they been companies. Section 1A sets out the different presentation and disclosure requirements for such entities. However, there are no recognition and measurement simplifications.

The revised version of FRS 102 (issued in September 2015), which includes the new Section 1A and has been amended to ensure compliance with other relevant recent changes to company law, is effective for accounting periods beginning on or after 1 January 2016. Early adoption is available for accounting periods beginning on or after 1 January 2015 – but only if the recent changes to company law have also been adopted from the same date, and vice versa.

This means, for example, that an entity early adopting the recent company law changes, including the increased thresholds, is not permitted to apply the FRSSE 2015 for that year – that is, it would be required to apply the revised FRS 102, including Section 1A.

Micro-entities

FRS 105 applies to entities that are eligible for and choose to apply the micro-entities regime.

The standard is based on FRS 102, although it has been adapted significantly to accommodate the legal requirements of the micro-entities regime, for example the very limited disclosure requirements and prohibition – yes, prohibition – on revaluing or subsequently measuring assets or liabilities at fair value. In addition, further simplifications, over and above those required by law, have been made in order to reflect the smaller size and simpler nature of

The UK government has proposed amendments to the LLP regulations to ensure equivalence with the recent changes to UK company law. The amendments also extend the micro-entities regime to both LLPs and qualifying partnerships

IAN WHADCOCK/IKON

	ACCOUNTING STANDARD OPTIONS				
	FRS 105	FRS 102 (Sept 2015)		FRS 101 (Sept 2015)	EU-adopted IFRS
		Applying Section 1A	Not applying Section 1A		
Eligible entities choosing to apply the micro-entities regime	✓				
Entities eligible to use the small companies regime		✓	✓	✓ (if a qualifying entity under FRS 101)	✓
Entities not small and not required to apply EU-adopted IFRS			✓	✓ (if a qualifying entity under FRS 101)	✓
Listed groups and other entitites required to apply EU-adopted IFRS					✓

micro-entities. For example, there are no accounting policy options, and accounting for deferred tax is not permitted - yes, not permitted!

FRS 105 is effective for accounting periods beginning on or after 1 January 2016, with early adoption allowed. Therefore a company choosing to apply the micro-entities regime is permitted to apply the new accounting standard for periods beginning before 1 January 2016.

ASSESSING OPTIONS

In the table above we have tried to summarise the options available under the revised UK GAAP regime.

Under the revised regime, some entities will be faced with a choice between applying the micro-entities regime and FRS 105, or the revised small companies regime and FRS 102 with Section 1A. The accounting regime and standard that apply will, of course, depend on the circumstances of each company. However, some factors to consider include:

- **Users of the financial statements** - the information required in micro-entity accounts is significantly less compared to accounts prepared under the small companies regime. Current and potential creditors and lenders to the business may require more information than provided by the micro-entity accounts.
- **Future growth plans** - a company that qualifies as a micro-entity but is growing and close to the size limits should carefully consider whether it makes sense to adopt the micro-entities regime.

Under the revised regime, some entities will have the choice between applying the micro-entities regime and FRS 105, or the revised small companies regime and FRS 102 with Section 1A

- **Minimum accounting items** - the micro-entities regime sets out ‘minimum accounting items’ to be included, when relevant, in micro-entity accounts. However, if a micro-entity chooses to include additional information in the accounts it must refer to the relevant requirements of Section 1A of FRS 102. If a micro-entity expects to disclose extra information it may wish to consider applying the small companies regime instead.
- **Accounting differences** - while there are different presentation and disclosure requirements for small entities applying FRS 102, there are no simplifications to the recognition and measurements requirements. On the other hand, FRS 105 is based on FRS 102 but with significant simplifications. Therefore FRS 105 may prove an attractive option for the smallest entities not keen to apply the more complex accounting treatments found in FRS 102.
- **Account formats** - micro-entity accounts are simpler than ‘full’ accounts prepared under the small companies regime. However, there are fewer formats available and less flexibility. In addition, micro-entities are not permitted to take advantage of the recent amendment to UK company law that allows companies, in certain circumstances, to adapt their balance sheet and profit and loss account formats in order to adopt an IFRS layout and IFRS terminology.
- **True and fair** - although the recent changes to UK company law limit the number of disclosures that can be required by law in small company accounts, those accounts are still required to give a true and fair view. Judgement will be needed when considering whether further disclosures, over and above those specifically required by law (and referred to in Section 1A of FRS 102) are needed to show a true and fair view. In contrast, micro-entity accounts that include the minimum accounting items are presumed by law - rather oddly - to give a true and fair view.

The new flexibility and options - while welcomed by many - need careful consideration to ensure that the outcome is optimal for both the reporting entity and the users of its financial reporting.

Nigel Sleigh-Johnson is head of the Financial Reporting Faculty
Sarah Dunn is a technical manager in the Financial Reporting Faculty

Time to wave farewell to the FRSSE

Stephanie Henshaw explains the key issues that small companies will need to consider when transitioning from the FRSSE to FRS 102

For periods beginning on or after 1 January 2016, small companies will fall within the scope of FRS 102. That means they'll have to adopt recognition and measurement requirements that, in some instances, are quite different from those in the dear old FRSSE. Small companies and their advisers will need to be familiar with the entirety of FRS 102, notwithstanding the more restricted disclosures of Section 1A.

This article looks at the major differences between FRSSE 2015 and FRS 102 and aims to highlight some of the implementation challenges and emerging issues.

Most of the differences are the same as those faced by larger companies that have already converted from old UK GAAP to FRS 102. However, there is one instance where FRSSE imposed less onerous requirements on small companies, a relaxation that does not continue under FRS 102.

SHARE-BASED PAYMENT

There is a distinct difference here between the FRSSE and FRS 102 for small companies because the former standard allowed them simply to disclose the existence of a share-based payment arrangement (eg, a share option scheme) in the notes to the accounts. There is no such exemption in FRS 102, so small companies will have to record share options etc at fair value at the date of issue, which means undertaking a valuation exercise.

FINANCIAL INSTRUMENTS

As discussed in more detail by Helen Shaw on pages 12-13, financial instruments accounting is potentially the biggest area of change for small companies.

FRSSE did not refer to 'financial instruments', so small companies may not appreciate that routine items such as trade debtors, trade creditors, bank loans and loans to and from directors fall under that heading just as much as more esoteric items such as interest rate swaps, forward currency contracts and similar arrangements. The concept of analysing items between basic and other instruments will be a new one, and although many small companies will find that, in practice, their financial instruments are relatively straightforward, they will still need to go through the exercise of identifying and examining them. In addition, the measurement requirements may mean small companies will have to re-evaluate the way they record existing arrangements. For example:

- **Loans to and from the company** – must be carefully reviewed to determine whether they meet the criteria to be treated as basic financial instruments. Issues such as the basis on which interest is charged can affect this categorisation.
- **Basic loans** – must be measured at amortised cost using the effective interest rate method. This means looking at all the cash flows under the loan including arrangement fees and related costs, which small companies may currently write off to the profit and loss account at the inception of the loan.
- **Financing arrangements** – if a loan is interest free and is not due on demand, amortised cost is approximated by discounting the initial amount of the loan at a market rate of interest.
- **Derivative instruments, such as forward currency contracts, other forward rate agreements and interest rate swaps** – must be recognised at their fair value at the balance sheet date, with any subsequent change in fair value being taken to the profit and loss account (unless hedge accounting is applied). This means bringing new assets and liabilities onto the balance sheet, with a consequent impact on net assets and net current assets.

OTHER IMPORTANT DIFFERENCES

Other important differences include:

- **Holiday pay** – under FRS 102 companies must provide for the cost of any unused holiday entitlement earned at the year-end, whereas the FRSSE was silent on the topic.
- **Lease incentives** – under the FRSSE lease incentives such as reverse premiums or rent holidays were spread over the period to the date when the rent was adjusted to market rate (usually the first rent review date). Under FRS 102, such incentives must be spread over the entire period of the lease. This change applies equally to both landlords and tenants.
- **Deferred tax** – under the FRSSE, deferred tax was only provided on timing differences, with specific exclusions for revaluations and rolled over gains. FRS 102 requires deferred tax provisions on revaluations and rolled over gains and on differences between fair and tax written-down values on acquisition of a business.
- **Investment properties** – under the FRSSE, investment properties were revalued to market value via the revaluation reserve. By contrast, FRS 102 requires them to be carried at fair value (which broadly equates to market value), adjusted through the profit and loss account. Companies will no longer recognise a revaluation reserve as all valuations will form part of accumulated profit or loss.
- **Foreign currency transactions** – the normal principle, that transactions must be translated at the rate in force at the date

BEN SANDER/IKON, GETTY

One important point to note is that small company accounts must still give a true and fair view. While this is not new, the FRSSE provided a fairly comprehensive set of disclosures, so it was relatively rare for companies to include extra detail

of the transaction, is unchanged. However, there is no option in FRS 102 to translate transactions at the rate under a related forward contract. Companies that have previously used this option will need to restate their stock at the spot rate at the date of purchase. Similarly, debtors or creditors previously translated at the forward contract rate will need to be translated at the year-end rate instead.

Of course, not all the changes above will apply to every small company. Some will only be affected by one or two items, while others may find that the individual and aggregate impact of FRS 102 on their financial statements is immaterial.

FIRST-TIME ADOPTION

Any company adopting FRS 102 for the first time is required to restate retrospectively its accounts as though the new rules had always applied. That means restating:

- the opening balance sheet at the start of the first year in which FRS 102 is applied;
- the profit and loss account for the comparative year; and
- the opening balance sheet at the start of the comparative year (which is known as the 'transition date').

Section 35 of FRS 102 contains four mandatory exceptions and 18 optional exemptions from restatement that apply to all companies, plus three further exemptions that apply specifically to small companies. These exemptions - and the whole process of creating your transition date balance sheet - are discussed further in Matt Howells' article on pages 14-15.

PRESENTATION

Now let's turn to the question of how small company accounts will be presented under FRS 102.

Most small companies are likely to choose to apply Section 1A, which reflects the new, restricted disclosure provisions of the EU Accounting Directive. The disclosures are set out in detail in Section 1A and are discussed further in Tessa Park's article on page 17, so are not repeated here.

One important point to note is that small company accounts must still give a true and fair view. While this is not new, the FRSSE provided a fairly comprehensive set of disclosures, so it was relatively rare for companies to include extra detail. Under Section 1A, small companies will have to exercise judgement in deciding what additional information, if any, is necessary to achieve a true and fair view.

Section 1A contains some helpful signposts, for example by 'encouraging' additional disclosure in specific circumstances (see Appendix D in particular). Companies may simply decide to incorporate some of the mainstream disclosures from FRS 102 where an item is material or more information is necessary to explain the nature and impact of the arrangement. For example, although Section 1A does not mandate a transition statement, if there are a number of adjustments it may make sense to follow the mainstream provisions.

Each company will be different and that presents a real challenge for directors, preparers and auditors who will all have to focus more attention on what is needed to give a true and fair view in each individual case.

Stephanie Henshaw is technical standards partner at Francis Clark and chair of the Financial Reporting Faculty board

Applying FRS 105: Rising to the challenge

Danielle Stewart OBE explores the challenges involved for companies transitioning from the FRSSE to the new financial reporting standard for micro-entities

YENPITSU NEMOTO/IKON

For accounting years commencing on or after 1 January 2016, the Financial Reporting Standard for Smaller Entities (FRSSE) will be withdrawn. This presents entities that have been using it with a three-way choice: converting to FRS 105 *The Financial Reporting Standard applicable to the Micro-entities regime*; switching to Section 1A of FRS 102; or adopting the full rigour of FRS 102.

Many entities will surely choose to switch from the FRSSE to FRS 105. But they will face a number of specific areas of challenge. Three of the main challenges are outlined in this article, as follows:

a) not all entities that used the FRSSE can use FRS 105 (ie, there are differences in scope);
b) there are measurement differences between the two standards; and
c) there are new formats to get to grips with.

SCOPE

The micro-entities regime was designed for companies. There is nothing in FRS 105 to say that it may not be used by unincorporated entities, but neither does the standard have anything positive to say on whether HMRC will accept it. This is an area to watch.

The criteria for using FRS 105 include qualitative characteristics and size limits. From a qualitative perspective, if an entity was not entitled to use the FRSSE, then it will not be able to use FRS 105 either (eg, a PLC or an authorised insurance company). Additionally, LLPs and 'qualifying partnerships' were only scoped in by a March 2015 statutory instrument, and charities will never be entitled to adopt the standard.

There are also some complicated rules around groups, which you should refer to if applicable.

The size limits for use of FRS 105 are as follows:

- turnover - not more than £632,000;
- balance sheet total - not more than £316,000; and
- average number of employees - not more than 10.

MEASUREMENT DIFFERENCES

The biggest challenge when adopting FRS 105 will be the measurement differences encountered when switching from the FRSSE.

No fair values

The micro-entity regulations do not permit companies adopting the regime to apply fair value accounting or the alternative accounting rules. This means there can be no revaluations or subsequent measurement at fair value.

There are three areas where a company using the FRSSE could revalue, but they won't be able to under FRS 105. These are investment properties, investments in shares and property, plant and equipment. This restriction is likely to discourage property investment companies from using the new standard, even though the size parameters might allow them to do so.

No capitalisation of costs

Under the FRSSE, you could capitalise both development costs and borrowing costs if certain conditions were met. Neither of these categories of cost can be capitalised under FRS 105 – instead they must be written off to the profit and loss account.

The biggest challenge will be the measurement differences encountered when switching from the FRSSE

No deferred tax

There is no requirement to provide deferred tax under FRS 105. This will be a relief to the directors/proprietors of most small entities, who seldom see the point of a deferred tax provision.

Defined benefit pension plans

Under the FRSSE, the surplus or deficit on a defined benefit plan was recognised on the balance sheet, either as an asset or liability as appropriate. Under FRS 105, the scheme surplus or deficit is not recognised, but if there has been a specific agreement to fund the deficit, this will be recognised as a liability. Contributions payable to the plan will be accounted for as an expense.

Foreign exchange

Under the FRSSE, contracted rates for foreign exchange contracts could optionally be used to translate foreign currency transactions. Under FRS 105, there is no option – the contracted rate must be used.

Lease incentives

Under the FRSSE, lease incentives were spread over the shorter of the lease term and the period to the next rent review. Under FRS 105, the incentive is spread over the entire lease term.

Goodwill

Where a trade and asset acquisition has taken place, intangible assets purchased with the business cannot be recognised separately from goodwill under FRS 105, whereas they were under the FRSSE if their value could be measured reliably.

The finite life of goodwill and intangibles under the FRSSE could not exceed five years where no reliable estimate could be made of its length, whereas this period is 10 years under FRS 105.

Finally, an impairment loss on goodwill cannot be reversed under FRS 105, whereas it could be under the FRSSE if the external event that caused the original impairment had been reversed by subsequent events.

Format of accounts

The micro-entity regulations set out the rules on the format and content of micro-entity accounts. These are referred to as the 'minimum accounting items'.

Accounts that include only these minimum accounting items are presumed by law to give a true and fair view, so if you want to add more disclosures, you must take care.

A complete set of accounts under FRS 105 comprise a statement of financial position, with any notes that are required being included at the foot of the statement, together with an income statement. If you prefer, either statement can be called by its previous name of balance sheet or profit and loss account.

There are two formats for the balance sheet and only one for the profit and loss account. They are quite rigid – the names of the various lines cannot be changed or combined and a company using the micro-entity formats cannot take advantage of the new flexible formats, which allow IFRS headings etc.

The two notes that need to be made at the foot of the balance sheet, where applicable, are:

- details of directors' advances, credits and guarantees; and
- additional details of any guarantees and other financial commitments.

There is not enough space here to set out the formats themselves.

When filing micro-entity accounts with the Registrar of Companies, only the statement of financial position needs to be filed, although both statements must be made available to members.

There must also be a statement on the balance sheet to the effect that the micro-entity accounts have been prepared in accordance with the provisions applicable to micro-entities.

CONCLUSION

Lenders and credit agencies need a certain amount of information in order to make their decisions. If you accept that more information results in better decisions, then the directors must weigh up the consequences of a micro-sized company producing such limited accounting information. While it is too early to tell what impact micro information will have on a company's ability to obtain trade credit, the directors should certainly be sounding out their stakeholders and considering producing non-statutory information that wouldn't otherwise be in the public domain.

Danielle Stewart is head of financial reporting at RSM and a member of the Financial Reporting Faculty board

Financial instruments: A whole new ball game?

Helen Shaw looks at what will be one of the biggest challenges for many entities transitioning to the new regime

The impact of transition from the FRSSE on an entity's financial instruments accounting will depend very much on whether the entity is adopting FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* or FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*.

FRS 102 introduces an entirely new model for classification and measurement of financial instruments that requires some financial instruments to be measured at fair value through profit or loss (FVTPL). This would not be appropriate for micro-entities as fair value accounting is prohibited for them by law. Consequently, micro-entities will continue to use cost-based measurement under FRS 105, which largely seeks to formalise, rather than amend, current practice.

Although small entities reporting under FRS 102 will be subject to fewer disclosure requirements than larger entities, the full recognition and measurement requirements of FRS 102 apply to all entities adopting that standard regardless of their size. Therefore, as for larger entities, the accounting for financial instruments will be one of the biggest challenges for small entities transitioning to FRS 102. The later mandatory effective date of FRS 102 for small entities currently applying the FRSSE at least means that they can take into account the lessons learned by larger entities when planning for transition. In this article I seek to relate some of the issues that have affected larger entities to small and micro-entities on withdrawal of the FRSSE.

BASIC AND OTHER INSTRUMENTS

FRS 102 classifies all financial instruments as either basic or other. How an instrument is measured depends both on this classification and the type of instrument. FRS 102 requires most other financial instruments to be measured at FVTPL. However, it also requires all investments in ordinary and preference shares, whether basic or not, to be measured at FVTPL unless the fair value cannot be reliably determined.

Where financial instruments are measured at FVTPL, a valuation must be obtained at each reporting date. This may be a challenge for many entities transitioning from the FRSSE and small entities should consider how they will obtain the necessary valuations well in advance of preparing their first FRS 102 financial statements. Although FRS 105 differentiates between investments in shares, derivatives and other financial instruments, the measurement of all financial instruments is based on cost rather than fair value.

CLASSIFICATION CRITERIA

Classification as basic or other for debt instruments under FRS 102 is based on specific criteria rather than an overarching principle. Therefore, an instrument cannot be classified as basic on the grounds that the entity considers itself to be simple or the instrument to be common.

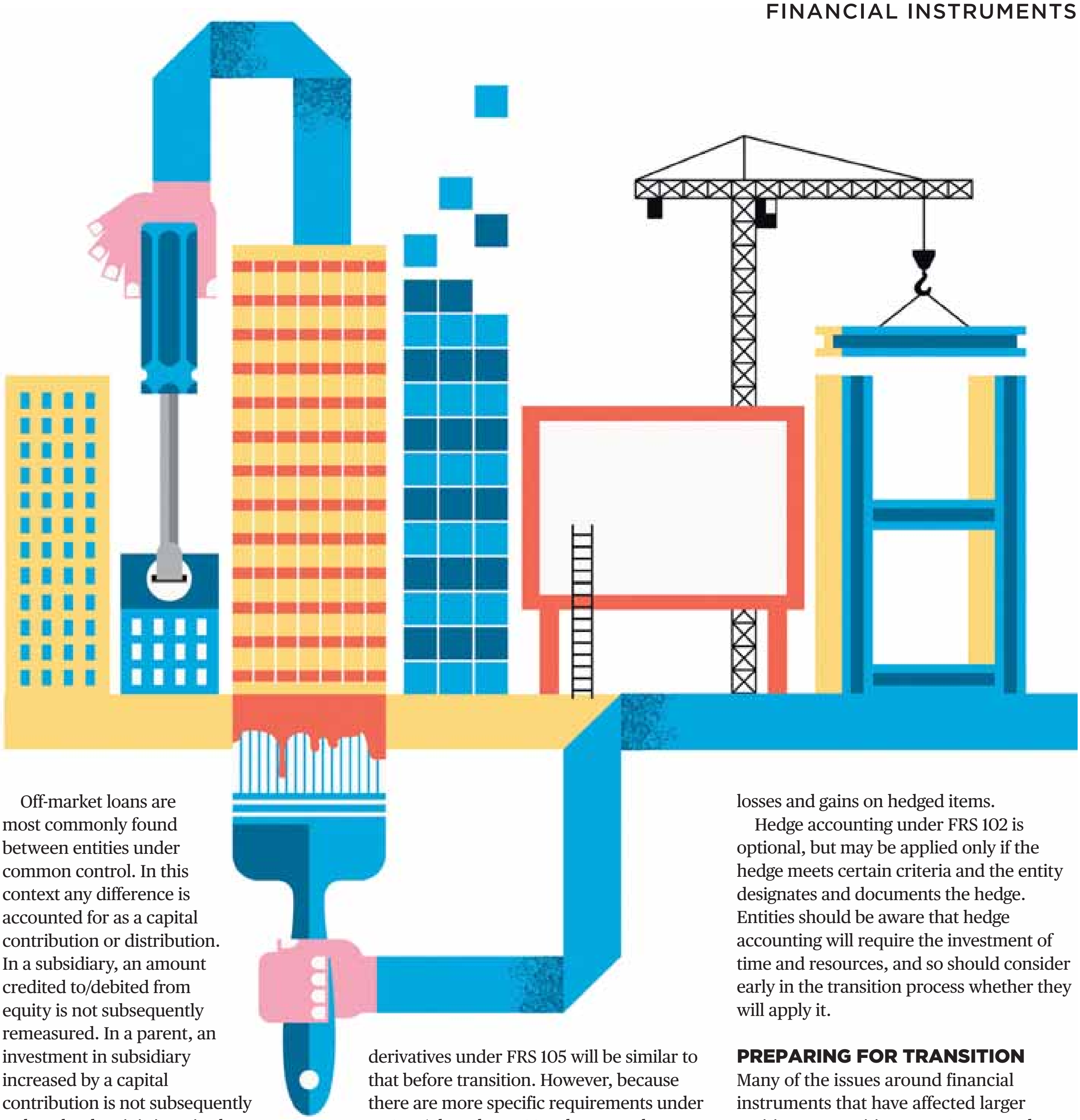
Classification as basic is restricted by reference to the instrument's returns and how those returns change over the life of the instrument. Certain prepayment and extension features could also prevent the classification as basic of some instruments. Moreover, the standard prohibits derivatives and instruments with contractual terms that could result in the loss of principal or accrued interest being classified as basic.

An example of a debt instrument that will generally be classified as other is an investment in convertible debt, because the equity-linked return breaches the criteria. To be basic, a debt instrument must comply with all of the criteria; this means a single non-basic feature will cause a debt instrument to be classified as other. Therefore on transition to FRS 102 all the terms of a debt instrument will need to be identified and assessed to determine whether or not the criteria are met.

LOANS AT NON-MARKET RATES

Surprisingly, one of the most prevalent issues for entities transitioning to FRS 102 affects basic debt instruments. If a basic loan is not at a market rate of interest (ie, it is 'off-market') it will, on initial recognition, need to be measured at an amount based on the present value of the future cash flows rather than the value of the consideration received. Unless the off-market loan is repayable on demand (ie, the lender can demand repayment at any time), there is likely to be a difference between the value of the consideration received and the initial carrying value of the loan.

Surprisingly, one of the most prevalent issues for entities transitioning to FRS 102 affects basic debt instruments



Off-market loans are most commonly found between entities under common control. In this context any difference is accounted for as a capital contribution or distribution. In a subsidiary, an amount credited to/debited from equity is not subsequently remeasured. In a parent, an investment in subsidiary increased by a capital contribution is not subsequently reduced unless it is impaired. The same issue will not arise under FRS 105 as debt instruments will be measured at initial recognition based on their cost.

DERIVATIVES AND HEDGING

Derivative financial instruments are commonly used to manage the risks an entity is exposed to (ie, they are hedging instruments) and entities reporting under the FRSSE would have accounted for them in combination with the item hedged (eg, accounting for floating rate debt and an interest rate swap as fixed rate debt).

Under both FRS 102 and FRS 105, derivative financial instruments will be separately recognised on balance sheet from the trade date. Apart from being recognised separately, the treatment of derivatives under FRS 105 will be similar to that before transition. However, because there are more specific requirements under FRS 105 than the FRSSE, there may be differences for some entities. Therefore entities transitioning to FRS 105 should confirm whether their current practice is compliant with the requirements.

Derivative financial instruments will be measured at FVTPL under FRS 102 because they are not basic. However, the risks hedged by these instruments may not be measured on the same basis. For example, the hedged item may be a forecast transaction not yet recorded in the financial statements or it may be an existing asset or liability measured at cost. This can give rise to artificial volatility in profit or loss, so FRS 102 allows an entity to apply hedge accounting, which is designed to reduce volatility by matching gains or losses on hedging instruments with the recognition of losses and gains on hedged items.

Hedge accounting under FRS 102 is optional, but may be applied only if the hedge meets certain criteria and the entity designates and documents the hedge. Entities should be aware that hedge accounting will require the investment of time and resources, and so should consider early in the transition process whether they will apply it.

PREPARING FOR TRANSITION

Many of the issues around financial instruments that have affected larger entities on transition to FRS 102 are also relevant to small entities. Considering these issues well in advance will give smaller entities the best chance of mitigating them effectively.

Entities transitioning to FRS 105 will not be subject to the same challenges, but should not assume that transition will not affect their financial instruments accounting without first reviewing the requirements.

Helen Shaw is a senior manager in the UK technical department at Deloitte

JOHN DEVOLLE/IKON

Creating your transition date balance sheet

Matt Howells considers the first steps small and micro-entities need to take on adopting FRS 102 or FRS 105

WHEN IS THE TRANSITION DATE?

This isn't the first year end in which you adopt the new standard. It's the beginning of the comparative period that you present in your first accounts prepared under FRS 102 or FRS 105.

Throughout this article, I'll use the example of a company with a December year-end that isn't adopting the new standard early. Its first accounts under the new standard will therefore be for the year ended 31 December 2016. If the directors present one year's worth of comparatives, the transition date will be 1 January 2015.

WHY DO I NEED A BALANCE SHEET AT THAT DATE?

It may seem odd to have to prepare a balance sheet two years before your first year-end under the new standard, but both FRS 102 and FRS 105 generally require full retrospective application.

My example company will need to prepare its 31 December 2016 accounts as though the new standard had always applied, with the 2015 comparatives and opening reserves restated accordingly.

An opening balance sheet for the 2015 comparatives prepared under the new standard will therefore be needed, with assets and liabilities recognised according to the new standard's requirements. This may mean:

- recognising new assets and liabilities;
- removing some existing ones;
- moving some to new headings; and/or
- recalculating their carrying values.

Note that the transition date balance sheet does not need to be included in the accounts themselves.

ARE THERE ANY EXCEPTIONS TO THIS GENERAL RULE?

Both FRS 102 and FRS 105 contain a number of mandatory exceptions to the general rule of full retrospective application. These are areas where you are prohibited from applying the new standard retrospectively. There are also a number of optional exemptions from full retrospective application, from which entities are free to pick and choose. Some of the key ones are dealt with below.

ACCOUNTING ESTIMATES

Estimates that still have force at the transition date cannot be changed with hindsight (assuming they weren't actually made in error).

Take for example a company with a 31 December year-end which isn't adopting FRS 102 or FRS 105 early. When the directors prepared the balance sheet under the FRSSE for the year ended 31 December 2014, it included a debtor that was considered to be recoverable, based on the information available at the time. After the accounts were signed, the debtor became insolvent and the debt had to be written off.

When preparing the transition date balance sheet (as at 1 January 2015), you would not use hindsight and write the debtor off at that point - it would still be included.

FINANCIAL INSTRUMENTS

Financial instruments include items such as trade debtors, as well as more complex instruments such as interest rate swaps. There are some exceptions on transition in this area:

- Any financial instruments that were removed from the balance sheet before the transition date are not brought back onto the transition date balance sheet, even if FRS 102 or FRS 105 would otherwise require them to be recognised.
- Conversely, if a financial instrument was on balance sheet under the FRSSE, but FRS 102 or FRS 105 would have required it to be removed, as long as the relevant transaction took place before transition there is a choice of including or excluding it in the transition date balance sheet.

Because of the more complex measurement rules in FRS 102 compared to FRS 105, there are a couple of useful exemptions under the former:

- If FRS 102 requires you to bring a financial instrument onto your

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balance sheet at fair value, you don't have to restate your comparatives or bring it onto your transition date balance sheet. Instead you bring it onto your balance sheet on the first day of the current period (sticking with the example of a company with a December year-end that isn't adopting early, this would be at 1 January 2016).

- If you have a financing transaction involving a related party (for example a fixed-term loan from a controlling shareholder that doesn't carry a market rate of interest), again your comparatives don't need to be restated and the transition date balance sheet can continue showing the FRSSE carrying amount. For our example company, the calculation to show the item at the present value of expected future payments will be done at 1 January 2016.

ACQUISITION OF TRADE AND NET ASSETS OF A BUSINESS

It could be onerous for an entity to have to revisit past acquisitions. Fortunately, there is an exemption under both FRS 102 and FRS 105 from having to do so for business combinations that happened before the transition date. If this exemption is taken, intangible assets subsumed within goodwill under the FRSSE are not recognised separately in the transition date balance sheet, and there is no adjustment to the carrying value of goodwill at transition.

LEASE INCENTIVES

Lease incentives are spread over the lease term under both FRS 102 and FRS 105. Under the FRSSE, the period over which they were spread may have been shorter, as it would have ended on the date from which a market rent was expected to be payable (eg, a rent review).

For leases which commenced before the transition date, an exemption is available which allows you to continue with the FRSSE treatment. This choice will affect both your reported and taxable profits, so it's advisable to consider the effect on both of the two possible treatments.

SHARE OPTIONS AND OTHER EQUITY-SETTLED SHARE-BASED PAYMENTS

The FRSSE did not require these payments to be recognised in the accounts. FRS 102, however, requires their recognition using similar principles to those found in FRS 20, resulting in recognition of an expense over the vesting period.

However, there is an exemption (assuming you didn't previously apply FRS 20 rather than the FRSSE) from applying FRS 102 to grants made before the start of the first FRS 102 reporting period (1 January 2016 for our example company).

FRS 105 requires a similar accounting treatment to the FRSSE.

INVESTMENT PROPERTIES

If you're adopting FRS 102, investment properties will be included on the balance sheet at valuation, as they were under the FRSSE. However, under FRS 105 they must be carried at cost less depreciation and impairment. In your transition date balance sheet, it is possible to use an approximation of the depreciated historic cost of each major component.

DEEMED COST OF ASSETS

Under FRS 102, there are several useful exceptions to and exemptions from retrospective application here.

- The carrying amount under the FRSSE of some assets can be brought into the transition date balance sheet unchanged, namely:
  - capitalised development costs; and
  - investments in subsidiaries, jointly controlled entities and associates.
- Where an item of property, plant and equipment was revalued under the FRSSE, the revalued amount can be used as deemed cost in the transition date balance sheet. This effectively permits you to move from revaluing to holding at cost under the new standard.
- It is also possible to obtain a one-off valuation of an item of property, plant and equipment as at the transition date and use this as deemed cost on the transition date balance sheet. This enables you to benefit from a one-off boost in asset values in the balance sheet, although it does mean future depreciation will be higher, and it may be necessary to provide for deferred tax.

FRS 105 requires all such items to be carried at cost anyway.

DORMANT COMPANIES

Dormant companies are allowed to retain their old GAAP accounting policies under FRS 102 or FRS 105 until a balance changes or the company undertakes any new transactions.

CONCLUSION

The creation of the transition date balance sheet is a critical first step in moving from the FRSSE. The rules vary depending on whether the move is to FRS 105 or FRS 102. In both cases, it is highly advisable to spend time early on in getting to grips with each of the exceptions and considering the accounting, tax and business implications of utilising each of the available options.

Matt Howells is director and head of the National Assurance Technical Group at Smith & Williamson

Thinking beyond the standards

Marianne Mau considers the wider implications of moving to a new accounting regime and suggests thinking beyond the standards to help avoid some unintended consequences

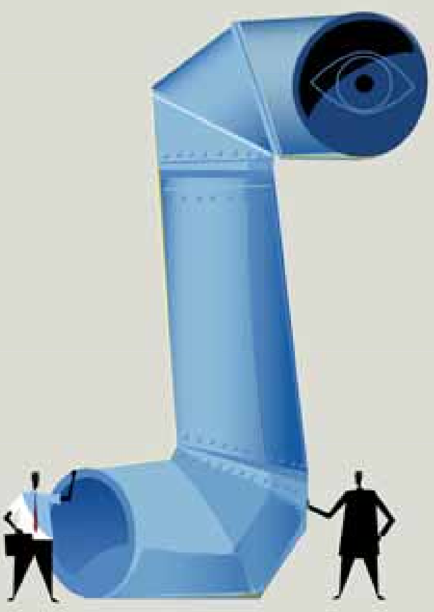
COMMUNICATING THE CHANGES

Financial reporting may well be considered a minority sport in most businesses, but it is important to identify who needs to be made aware of the major changes ahead and the level of detail that is appropriate for their needs.

So, apart from those involved in preparing the accounts, who else needs to be kept informed?

The board

Ultimately the directors are responsible for the preparation and approval of the accounts. Therefore the board needs to be made aware of the implications of the move to the new regime for the reported results of the business. But there are also resourcing and other practical implications that they need to consider. This article considers some of these broader issues.



Key staff

There are some key differences in the way that some - possibly run-of-the-mill - transactions are accounted for under the new standards. Therefore it is important that staff responsible for drafting and approving contracts are aware of the risks of introducing unnecessary complexity into the terms and conditions of any business arrangement. This is particularly true for financing transactions, but purchase and sales agreements may also be affected if, for example, they include a financing element.

Furthermore, if there are any existing contracts linked to earnings or amounts recognised in the balance sheet, for example profit-related pay or bank covenants, staff responsible for monitoring these arrangements will need to be able to consider the implications and identify the appropriate course of action.

Other stakeholders

The business needs to identify who else is likely to be making use of the financial statements and whether they need to be forewarned of the impending changes. Interested parties are most likely to include the shareholders and any other providers of finance, for example banks. However, they may also include suppliers and customers where the relationships are critical to the business.

IDENTIFYING RESOURCING IMPLICATIONS

Moving to a new accounting standard may require additional expertise and systems changes. The level of investment required is likely to vary significantly according to the size and complexity of the business. For some there may be material costs associated with first-time adoption of a new standard, so directors may need to approve additional expenditure or consider other means by which sufficient resources can be made available to implement the changes.

Training

Any staff involved in the preparation of the accounts are likely to require some form of training, whether it be online, attending one of the many courses available, or in-house. For the larger or more complex business it may be cost-effective to bring in outside expertise to supervise the transition.

Accounting and business systems

The accounting systems must be able to gather the data required to fulfil the requirements of the new standard. For many smaller business, the upgrades available to their existing accounts preparation packages may well be sufficient for their needs. But this should not be assumed to be the case.

Specialist knowledge

Meeting the requirements of FRS 102 in particular may require some specialist knowledge, for example to value derivatives, such as interest rate swaps, or share options. The business will need to consider whether it has sufficient expertise in-house to perform these valuations, whether additional training is necessary or, in particularly complex scenarios, whether the expertise needs to be brought in from elsewhere.

TIME IS OF THE ESSENCE!

The new standards generally require retrospective application, so it's important to identify those areas most likely to have a significant impact on the financial statements and actions which might be taken to ease the transition. In particular, it is important to identify at an early stage those actions that are time-critical ie, areas where action (or inaction) at transition has a direct impact on the accounting treatment and the options available.

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ROCCO BAVIERA/IKON

FRS 102 and small companies: the true and fair view dilemma

Tessa Park considers why recent changes to the accounting requirements for small companies have been causing some concern

In the past, small companies could follow the disclosure and measurement requirements of the FRSSE and company law and be happy that, barring exceptional circumstances, their accounts would show a true and fair view - but under FRS 102 this will no longer be the case.

The most recent EU Accounting Directive brought in limited disclosure requirements for small companies, now reflected in Section 1A of FRS 102, as revised in 2015. EU member states are now effectively prohibited from requiring additional disclosures for small companies, either in law or accounting standards. However, the accounts of a small company - unlike those of a micro-entity - are required to give additional disclosures if they are needed for the accounts to show a true and fair view. This introduces a new and significant degree of judgement into the financial reporting regime for small companies.

STILL REQUIRED

Some of the more significant disclosures that are still required (not a complete list) are:

- accounting policies adopted;
- fixed assets notes including, where relevant, details regarding revaluations and impairment;
- prior year adjustments;
- details of assets measured at fair value through profit or loss;
- off-balance sheet financial commitments, guarantees or contingencies;
- long-term (over five years) debtors and creditors;
- advances and credits granted to directors and guarantees entered into on behalf of directors;
- exceptional items;
- post-balance sheet events; and
- transactions with owners, directors or participating interests not concluded under normal market conditions.

Some additional disclosures will be required as a result of the retention of the Companies Act format headings eg, an analysis of debtors and creditors. But this still leaves a lot of potentially important disclosures that are not mandated - but which could be needed if the accounts are to show a true and fair view, given that small companies will be required to follow all the measurement requirements of the standard.

NO LONGER NEEDED?

Some of the more significant disclosures that are no longer required, but might be needed to show a true and fair view, are:

- a statement of comprehensive income and a statement of changes in equity (small companies are 'encouraged' in FRS 102 to present both of these if there are items which would normally be included);
- critical accounting estimates;
- share-based payments;
- the ultimate controlling party and other non-mandatory related party transactions; and
- various financial instruments disclosures.

Share-based payments are a good example of where judgement will be required - they may be highly material to one company and completely immaterial to another. Some small companies may have complex issues requiring judgement to determine the correct accounting treatment, which would need to be disclosed, whereas a straightforward company may have little that requires judgement other than basic estimates such as depreciation.

THE WAY FORWARD

So what should small entities - and their advisers - do? One option is to include all the disclosures required by the standard, perhaps omitting disclosures which were never required by the FRSSE eg, the cash flow statement. A minimal approach (disclosing only those items legally required) may well result in a set of accounts which do not give a true and fair view in some respect, and any audit report on those accounts would need to be modified.

A middle ground is probably the best approach. Paragraph 1A.17 of FRS 102 encourages small entities to provide the disclosures otherwise required by the standard where they relate to material transactions and events. In practice providing disclosures when they are material (and not when they aren't) has to be a sensible approach. A discussion between companies and their accountants at an early stage of the accounts production process will be a sensible way of determining what disclosures may be required - and may help to avoid headaches later on when the accounts are being finalised.

GARY WATERS/IKON

Tessa Park
is technical partner at Kingston Smith

The end of abbreviated accounts: the new options

Robert Carroll examines the options now available to small companies when filing their accounts

Companies entitled to small companies exemptions under the Companies Act 2006 (the Act) in preparing their accounts also have options when filing their accounts at Companies House. In the light of changes to the Act in 2015 to implement the new European Union Accounting Directive, companies may wish to explore these options further.

The legal changes apply to accounting periods beginning on or after 1 January 2016, but may be adopted earlier for periods beginning on or after 1 January 2015.

ABBREVIATED ACCOUNTS

Prior to the legal changes, small companies that are not micro-entities had to prepare 'full' accounts for their shareholders, applying the simpler small companies accounting requirements if they wished to. However, many small companies prepared a separate set of 'abbreviated' accounts for filing at Companies House. These accounts were derived from the full accounts and comprised only an abbreviated balance sheet and limited notes required by statute, but did not need to include a profit and loss account or disclosures required by accounting standards and were not required to give a true and fair view.

Many small companies filed abbreviated accounts as a way of minimising the information they placed on public record. If the company's accounts for its shareholders had been audited, a special auditor's report was required on the abbreviated accounts.

Abbreviated accounts are abolished from 2016.

ABRIDGED ACCOUNTS

The 2015 legal changes introduced 'abridged accounts'. These are different to abbreviated accounts. In essence, they are a full set of small company accounts except that the balance sheet and profit and loss account are simplified.

For the balance sheet, the third, most detailed level of headings, usually presented in the notes, may be omitted. More significantly, the profit and loss account may begin with gross profit with the figure for turnover omitted completely.

Unlike abbreviated accounts, abridged accounts are still required to give a true and fair view and additional disclosure may be necessary to achieve this.

If a company prepares abridged accounts, there will be no 'full' statutory accounts for its shareholders. However, abridged accounts can be prepared only if all of the company's members consent, and that consent must be obtained each year. It seems unlikely that many small companies will prepare abridged accounts given that, as explained below, they do not have to file the profit and loss account at Companies House and members are likely to continue to want to see a full profit and loss account.

'FILLETED' ACCOUNTS

When it comes to filing accounts at Companies House, the core principle underlying the new regime is that a company files what it prepares for its shareholders. So, if a small company prepares 'full' accounts, that is what it files, and similarly for abridged accounts. However, this is subject to a significant continuing exemption.

As an alternative to filing abbreviated accounts, small companies have long been permitted to file a copy of the accounts they prepare for shareholders but with the profit and loss account and related notes omitted – sometimes referred to as 'filleted' accounts. Unlike abbreviated accounts, that could be prepared only if a company prepared UK GAAP accounts for its shareholders, 'filleted' accounts could be filed even if a small company elected to prepare IFRS accounts.

This approach remains available, irrespective of what type of accounts are prepared for shareholders, and may prove attractive to companies that have previously filed abbreviated accounts and do not want to publish profit and loss information.

A significant change relates to companies that are audited. Hitherto, their 'filleted' accounts would have included the auditor's report, but this is no longer permitted. Instead, an additional note is included in the 'filleted' accounts giving information about the audit opinion.

Small companies continue to be exempt from having to file their directors' report, irrespective of what accounts they prepare and file.

Robert Carroll is a director in the UK technical department at Deloitte and a member of the Financial Reporting Faculty's editorial board

ANDREW BAKER/IKON

Tax implications of new UK GAAP

Paul Martin explores the major tax effects of the new accounting regime for small and micro-companies

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It has long been established that a business must pay tax on the profits of its trade and that the starting point for quantifying the taxable profits of that trade is the accounts. However, it is only as recently as 1998 that this basic principle became enshrined in statute. The current legislation for companies can be found at section 46 of the Corporation Tax Act 2009, which states that:"The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes."

Tax statute also now contains a definition of what is meant by GAAP. For companies that definition makes it clear that for the purposes of tax, GAAP includes both UK GAAP and International Accounting Standards.

MIND THE GAAP

In light of this statutory starting point, when GAAP changes there is a potential tax impact, particularly for those items where the tax treatment follows the accounting treatment (rather than replaces it with a separate treatment for tax purposes). To the extent that the change in GAAP is a presentational one or a disclosure one, there is no impact on the calculation of taxable profit. However, if the recognition or measurement rules for a particular item or transaction change there could be a knock-on effect for corporation tax.

For example, Section 1A of FRS 102 provides reduced disclosure for small companies and FRS 105 provides for simplified accounts for micro-entities, but neither of these relaxations will impact the calculation of corporation tax for the company. However, the changes in the recognition and measurement rules in FRS 102 for financial instruments (such as derivative contracts or certain non-market rate loans), lease incentives, intangible assets, biological assets and holiday pay accruals will potentially impact the corporation tax of a company applying these, as they are all areas where the tax treatment follows the accounting treatment.

TRANSITION

Any potential corporation tax impact will be increased in the first period for which the new accounting rules are adopted as the transitional adjustments that will arise on the switch to the new GAAP treatment will also be relevant for tax. Depending on the item, there may be a tax rule that allows such transitional adjustments to be spread over a certain period for corporation tax purposes or the full transitional amount may fall to be charged or deducted for tax purposes as part of the taxable profits of that first period in which new GAAP is applied.

Micro-entities applying FRS 105 will benefit from simplified accounts presentation and also in certain areas less complex accounting policies compared to FRS 102. However, the recognition and measurement requirements of FRS 105 do not differ significantly from the FRSSE 2015 and those that there are tend to be for items or transactions that are not relevant for corporation tax (for example the prohibition of deferred tax). This means that tax relevant adjustments arising on adoption of FRS 105 for an entity previously applying the FRSSE 2015 are likely to be fewer than those potentially arising for an entity adopting FRS 102 (including small companies applying Section 1A).

Companies should have a checklist of the implications of changes in the recognition and measurement rules

CHECKLIST

Companies should have a checklist of the implications of changes in the recognition and measurement rules of items or transactions in their accounts arising from the adoption of FRS 102 or FRS 105. The corporation tax implications and the knock-on effects on cash flows are clearly one of the key items that should feature on that list.

Paul Martin is a tax training manager at RSM

Distributable profits: the new regime

It is important to be aware of which profits are realised and which are not. **Ken Rigelsford** considers the impact of the new accounting standards

The distinction between realised and unrealised profits is important because dividends can be paid only out of realised profits. Also, for companies reporting under UK GAAP, unrealised profits cannot be included in the profit and loss account unless they arise from the use of the fair value accounting rules.

DRAFT GUIDANCE

TECH 02/10 *Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006* was issued in October 2010. Over the past five years nothing has changed regarding the principles for determining whether profits are realised profits. However, many of the references to accounting standards have become dated, particularly with the arrival of 'new UK GAAP'. So the opportunity has been taken to bring the guidance up-to-date with the publication of TECH 05/16BL *Exposure draft of updated guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006*.

INTRA-GROUP LOANS

TECH 05/16BL is in the form of a mark-up of the text of TECH 02/10. Many of the changes are merely updating references and removing obsolete material. The main substantive change affecting small companies is the additional guidance about intra-group off-market loans (eg, an interest-free loan from a subsidiary to its parent). The guidance will also be relevant to loans to or from controlling shareholders. Accounting for intra-group loans has been one of the most hotly-discussed topics about transition to FRS 102. This aspect of TECH 05/16BL is likely to attract most attention. There are two separate but connected issues.

When a subsidiary makes an interest-free loan to its parent, FRS 102 requires the difference between the fair value and the face value of the loan to be accounted for as a distribution. This has prompted people to ask whether that means it is legally a distribution. TECH 05/16BL confirms that the answer is yes, which means that such a loan can be made lawfully only if covered by distributable reserves.

The second aspect is concerned with the consequences of the other accounting entries. The guidance proposes that any interest receivable should be regarded as a realised profit. Reference should be made to TECH 05/16BL for a full understanding of the accounting entries and their consequences for realised and distributable reserves.

Companies that choose to apply FRS 105 and the micro-entities regime will not be affected by the change of accounting treatment for such loans. However, the guidance about whether it is lawful to make such loans is still relevant to them.

DEFERRED TAX

More generally, companies applying FRS 105 will usually be able to continue applying the same accounting policies as under old UK GAAP. An exception to this is that FRS 105 prohibits making provision for deferred tax. Retained profits may therefore increase on transition to FRS 105, potentially enabling the payment of higher dividends. However, companies always have to consider their solvency and liquidity when proposing to pay a dividend and must therefore still ensure that they have retained sufficient cash to pay their tax bills as they fall due.

COMMENTS

Comments were requested on the proposals by 9 June 2016. It is expected that the guidance will be issued in final form, taking into account the comments received, later in 2016. However, those aspects of the proposals dealing with legal issues, such as the definition of a distribution, should be regarded as having immediate effect.

Ken Rigelsford is a director in the UK technical department at Deloitte

Support from ICAEW

Trying to get your head around FRS 102? ICAEW offers technical advice, practical guidance, confidential support and a community network

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The faculty's 2016 roadshow will be visiting cities up and down the country this autumn. John Selwood will provide an update on the latest UK GAAP developments and make sure that you are aware of new and emerging issues.

Key topics to be covered at the roadshow include:

- lessons learned from applying FRS 102 in practice;
- the impact of the new EU Accounting Directive;
- the new regime for small and micro-entities;
- the new guidance on distributable profits; and
- the first triennial review of FRS 102.

Dates include:

- 13 September – Durham
- 21 September – Cardiff
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- 7 October – Manchester
- 17 October – Liverpool
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24 June 2016, London

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- applying FRS 102 in practice – new and emerging implementation issues;
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- impact on tax and distributable profits – expert advice on how you and your clients will be affected; and
- the new regime for small and micro-entities – getting to grips with life after the FRSSE.

SPEAKERS INCLUDE:

- Anthony Appleton (Director of Accounting and Reporting Policy at the FRC);
- Danielle Stewart (Head of Financial Reporting at RSM); and
- Ken Rigelsford (Director in Deloitte's UK technical department).

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