
SCR Reporting

Bulletin 2015 / 1

Welcome

Welcome to the first bulletin since the change of ownership. I appreciate it will be a hard job following Roger with his breadth of knowledge but we will try to maintain the scope and breadth of coverage. We also wish Roger well in his retirement.

This first bulletin under the new regime is very much a single issue bulletin dealing with the changes to UK GAAP and outlining the changes to the accounts checklists and manuals.

I look forward to receiving your feedback and if you do turn up on any of my training courses, do please introduce yourself as an SCR user.

Bill Telford

Editor

1 September 2015

The hard work starts now

We now know the final structure for the financial reporting framework in the UK and Ireland following the implementation of the EU Directive in the Companies, Partnerships and Groups (Accounts and Reports Regulations) 2015 and the issue of the new financial reporting standards by FRC on 16th July 2015, following their approval one month earlier.

On the following pages we give an overview of the changes, which will be dealt with in greater detail within the updated versions of the checklists and supporting materials, and how we at SCR will provide support and tools to assist you and your clients to manage the transition from old UK GAAP to new.

As you read through the Bulletin you will realise that the new financial reporting framework does not produce a one stop shop template for a standard set of accounts which can be applied for every client! There are typically **four** sets of choices to be made:

1. Under company law
 - a. Is the company eligible to use the small companies' regime or the micro-entities' regime?
 - b. If using the small companies' regime should it opt for abridged or full accounts?
2. **Between** accounting standards – which standard best fits the client's circumstances?
3. **Within** accounting standards – which accounting policy choice is most appropriate?
and
4. On transition – what transitional exemptions should the client take up?

You should consider each of your clients in turn and seek to identify which of the above issues are most relevant.

Company law changes

Before looking at the new structure of accounting standards it is essential that you understand the four key changes in company law which impact on reporting for small and very small companies:

- Revisions to eligibility arising from changes in size criteria and changes in definition of ineligible companies;
- Reduction in the number of notes for **all** small companies;
- The option for small companies to further reduce the information included in financial statements by preparing abridged accounts. This requires unanimous, annual shareholder approval and therefore may be impracticable for many small companies.; and
- The abolition of abbreviated accounts.

Revisions to size criteria

The approach to regulation under the Companies Act 2006 is one of building blocks, the higher the category the more detailed the disclosure and presentation requirements which apply. There are four categories – micro, small, medium and large, although, in practice, large is a catch all of anything that is neither micro, small nor medium. It therefore includes all those companies which would be small on a size basis, but which are ineligible under the regulations.

The revised regulations adopt the maximum size permitted by the Accounting Directive, and are as follows:

	Turnover		Balance sheet total		Employees	
	<i>Old</i>	<i>New</i>	<i>Old</i>	<i>New</i>	<i>Old</i>	<i>New</i>
Micro-company	632,000	632,000	316,000	316,000	10	10
Small company	6.5 m	10.2 m	3.26 m	5.1 m	50	50
Medium sized company	25.9 m	36.0 m	12.9 m	18.0 m	250	250
Small group						
Gross	7.8 m	12.2 m	3.9 m	6.1 m	50	50
Net	6.5 m	10.2 m	3.26 m	5.1 m	50	50
Medium sized group						
Gross	31.1 m	43.2 m	15.5 m	21.6 m	250	250
Net	25.9 m	36.0 m	12.9 m	18.0 m	250	250

For a parent to qualify as small it must head a small group. A group is a small group, if it meets the size criteria and is not an ineligible group. Note the two tests in determining whether a group is small, the net and gross tests, both of which are increased in line with the increase in individual company accounts.

The qualification rules require a company to meet at least two out of the three criteria for two successive years to qualify, except in the first year. Thereafter, if it fails to meet at least two out of three criteria for two successive years it loses the right to use the relevant provisions.

Link with audit requirement

Initially, BIS proposed to decouple the link between audit exemption and access to the small companies' regime. In the regulations they have not done so but state that they may be decoupled as a result of a current consultation on the implementation of the Audit Directive. In practice the fact that more companies qualify as small will, of course, increase the numbers of audit exempt companies.

Note that if a company early adopts the accounting regulations, there is no change in the limits for audit purposes.

Revision of the definition of ineligible companies

A public company has not previously been entitled to use the small companies' regime. BIS consulted on extending the eligibility rules to permit a plc to be within the small companies' regime, but decided not to go that far. They did, however, revise the definition of an ineligible group such that, although a plc itself cannot be a small company, a member of a group which contains a plc can be, unless the plc

is traded. Therefore a subsidiary of a plc which is not traded is eligible to use the small companies' regime. As such it will be eligible to use the simplified accounting requirements of company law and accounting standards and be audit exempt. It would also appear that such a company may qualify as a micro-company, if small enough. There are no other changes in eligibility.

Reduction in number of notes required for all small companies

The Accounting Directive prescribes a maximum number of notes which a small company is required to include. These have been included in the revised Accounting Regulations and are:

1. Accounting policies
2. Fixed assets revaluation table
3. Fair value(s)
4. Financial commitments, guarantees or contingencies not on the balance sheet
5. Advances & credits etc.
6. Items of exceptional size or incidence
7. Amounts due or payable after > 5 years and entire debts covered by security
8. Average number of employees during the year
9. Fixed Asset note
10. Name and registered office of the smallest entity producing consolidated accounts in which the company is included
11. Nature/purpose of arrangements not on the Balance Sheet
12. Material non adjusting events after Balance Sheet date
13. Related Party transactions (with scope for exemption for wholly owned group companies)

The government (and standard setters) are not allowed to include additional disclosure requirements. This is partly why the FRC has decided that the FRSSE should be withdrawn and small companies included within FRS 102. However accounts are required to be true and fair and the standard setters are faced with the problem of whether thirteen notes is sufficient to give a true and fair view.

The new abridged accounts regime

As well as making changes for all small companies by restricting the number of notes, the regulations permit a small company to prepare abridged accounts, as their statutory accounts. Note that the new abridged accounts regime is not to be confused with the old abbreviated accounts regime, whereby two sets of accounts were prepared, one for the shareholders and one, known as abbreviated accounts, for filing at Companies House. Under the new regime, the second set of accounts disappears, although the company is allowed not to file the profit and loss account and directors' report (see below).

Schedule 1 to the small companies and group regulations permits a small company to prepare abridged accounts, and the two areas of abridgement are:

- (a) The balance sheet need only include those items with an alphabetic and roman designation. These are the ones usually shown on the face of the balance sheet. Those items with an Arabic number prefix are usually shown by way of note but will no longer be required. Nor will any related notes; and
- (b) The profit and loss account can combine headings and start with gross profit. Note that this is not gross profit as we know it. In format 1, which currently includes gross profit, defined as turnover less cost of sales, abridged gross profit includes other operating income. Format 2 does not currently show gross profit. The abridged version is before staff costs. Typically direct labour costs are included in cost of sales and therefore within gross profit.

The regulations require the unanimous agreement of all shareholders to the preparation of abridged accounts. This agreement is required on an annual basis.

The point as far as taxation is concerned is that whereas old abbreviated accounts were for filing purposes, and HMRC would not accept them, instead receiving an IXBRL-tagged version of the "full" accounts, abridged accounts are the "full" accounts and therefore HMRC have to accept them.

Micro-entity accounts

The company law revisions make no direct changes to eligibility to use the micro-regime although the changes in small company eligibility could increase the number of eligible companies. To date it has been little used but at SCR we believe it should be the default position, especially following the

implementation of FRS 105 (see below.) Appendix 1 to this bulletin is an article explaining why we think you should consider adopting the micros regime for your clients.

Abbreviated accounts are dead

As noted above, it is no longer possible for a company to prepare two sets of accounts, one for shareholders, the full accounts, and one for filing at Companies House, the abbreviated accounts. This will not have much effect in practice for a small company, because it is eligible not to file the directors' report or the profit and loss account. Since the term profit and loss account includes the notes to the profit and loss account, the notes to the profit and loss account are not required. There are two important differences in practice between old style abbreviated accounts and the new filing requirements:

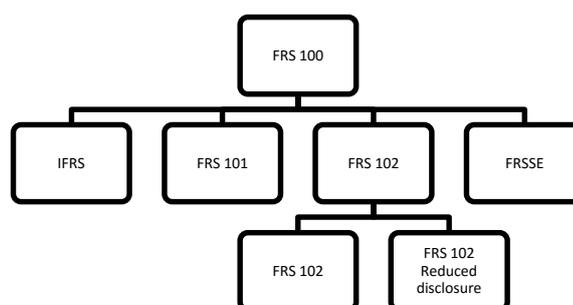
- (a) Since the accounts being filed are the full accounts, albeit with some pages omitted, there are no additional sign off or approval statements required on the balance sheet, and no special auditors' report if the company is audited. Note however that if the full accounts are filed and the company is audited the audit report is included. If the profit and loss account and directors' report are not filed, a statement is required
- (b) All of the notes to the full accounts which are not profit and loss account notes must be filed. This includes the related party transactions note, which would have been omitted from abbreviated accounts.

Note that medium sized companies are now also no longer permitted to use abbreviated accounts.

Revised structure of accounting standards

Initial changes

Initially FRC published new standards within the following structure:



A revised version of FRSSE (referred to as FRSSE 2015) was issued with some consequential amendments arising from the introduction of FRS 102 but this was not a major rewrite. The three changes to FRSSE 2008 introduced by FRS 100 to produce FRSSE 2015 are:

- (a) The FRSSE definition of related parties has been updated to that as included in FRS 8, now carried forward in FRS 102. This is a disclosure issue only;
- (b) A new paragraph 6.45A was introduced requiring that “at each reporting date an assessment shall be carried out of whether there is any indication that an asset should be written down (i.e. whether it’s carrying amount is more than its recoverable amount). If any such indication exists, the recoverable amount of the asset shall be estimated. If there is no indication that an asset should be written down it is not necessary to estimate the recoverable amount.”

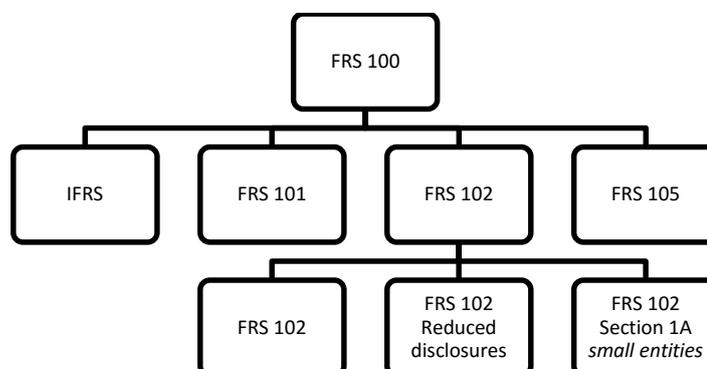
Even if the transition to FRSSE 2015 results in an accounting adjustment for impairment, it will not usually be allowable for tax as it is similar to depreciation and, as it relates to capital, and would be added back. The available capital allowances would not be affected.

- (c) The useful life of goodwill and intangible assets may not exceed five years if it cannot be measured reliably.

This may result in goodwill being written off earlier than under FRSSE 2008 and is the one element of the transition to FRSSE 2015 which might have a tax effect, since where goodwill amortisation is an allowable deduction, earlier write off will accelerate the tax relief. Whether or not it does, depends of course on the interaction with tax law.

Revised structure of accounting standards following the FRC consultation

On 16th June 2015, following the publication of the revised accounting regulations, FRC issued revised standards as outlined in the revised accounting framework.



FRSSE is withdrawn and a revised version of FRS 102 has been produced with guidance for small companies, incorporating the recognition and measurement principles of FRS 102 but applying the presentation and disclosure requirements of the updated formats and disclosure requirements of company law. Note that this is described as FRS Section 1A *small entities*. This is because all of the disclosure requirements have been included within that section and not because that is the only section a small company has to comply with! The recognition and measurement requirements for small companies are the same as in the rest of FRS 102

Note that FRS 102 remains as a single standard but will have three applications:

- (a) FRS 102 reduced disclosure applicable to qualifying entities;
- (b) FRS 102 provisions applicable to small entities; and
- (c) Full FRS 102 as applied by everybody else.

Note that (a) and (b) are primarily reductions in disclosure and do not affect the basic recognition and measurement criteria. For simplicity we will refer to the provisions applicable to small entities as FRS 102 for small entities as if it were a stand-alone document as was FRSSE. The structure of FRS 102 allows it to be read as such.

In addition, a new standard has been introduced, based on FRS 102, but designed for micro-companies. Initially it was thought that this might be known as the Financial Standard for Micro-Entities (FRSME), but it will now have been confirmed as FRS 105.

Therefore a small company which qualifies as a micro-company will have a choice between full FRS 102, FRS 102 for small entities and FRS 105. Since FRS 105 introduces simplified accounting for some areas, this may result in different accounting and / or taxable profit form that under FRS 102. There were no real differences in accounting between FRSSE and old UK GAAP, the differences primarily related to presentation and disclosure. Additionally FRS 105 does not give any accounting policy choices, and in general, the mandatory policy results in earlier recognition of income or expenditure rather than deferring to the balance sheet.

Effective date and transition

Revised company law regulations

The effective date is periods commencing on or after 1 January 2016, although early adoption is permitted for periods commencing on or after 1 January 2015. Note that the ability to early adopt only applies to the accounting regulations and not audit exemption. Therefore an entity with a turnover of £8m which is medium for the year ended 31 December 2014 can qualify as small for year ended 2015 and thus use FRS 102 for small entities and reduced disclosure options under CA 2006. However it will still require an audit in 2015!

In applying the two year test, eligibility is assessed against the revised limits, rather than those that were applicable at the time.

Accounting standards

The effective dates for the various standards are as follows:

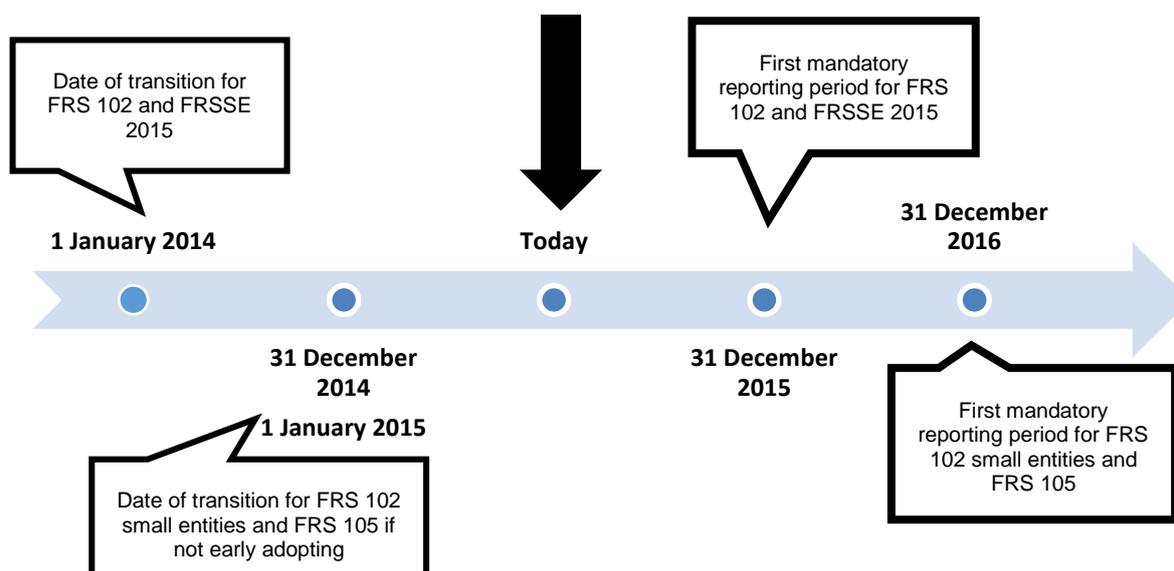
Standard	Effective date	Early adoption
FRS 102	Periods commencing on or after 1 January 2015	Periods ending on or after 31 December 2012
FRS 102 for small entities	Periods commencing on or after 1 January 2016	Periods commencing on or after 1 January 2015
FRS 105	Periods commencing on or after 1 January 2016	On issue (16 th June 2015) for periods ending after 30 September 2013

FRS 102 **permits** a company to early adopt FRS 102 for small entities, provided that it also applies the revised company law requirements from the same date. It also **requires** an entity to adopt FRS 102 for small entities if a company adopts the company law changes for a period beginning before 1 January 2016.

Transition under GAAP

An entity is required to restate its balance sheet (statement of financial position) at the date of transition which is defined as *“the beginning of the earliest period for which an entity presents full comparative information in a given standard in its first financial statements that comply with that standard.”*

For a company with a 31 December year end, this means that the date of transition for FRS 102 and FRSSSE 2015 is 1 January 2014, which is effectively 31 December 2013. If a small or micro-company does not early adopt FRS 102 for small entities or FRS 105 respectively, the first mandatory reporting date is periods commencing on or after 1 January 2016, and the date of transition is 1 January 2015. This can be illustrated diagrammatically as follows:



Note that where a small company chooses not to early adopt FRS 102 for small entities, or a micro-entity does not early adopt FRS 105, it will need to transition from FRSSE 2008 to FRSSE 2015 on 1 January 2015 and then again to FRS 102 for small entities or FRS 105 on 1 January 2016. However, for many entities the transition to FRSSE 2015 will not result in changes to the numbers recorded in the financial statements and in particular will not have a direct tax effect (see above).

Early adoption

As indicated above, the new standards can be adopted early. Note that early adoption does not, in general, change the requirement to restate accounts at the date of transition (but see below for exemptions available to small entities adopting FRS 102 for reporting periods commencing before 1 January 2017)! For example, if an entity wishes to adopt FRS 102 for the year ended 31 December 2014, its date of transition is 1 January 2013! It may be impracticable to restate the financial statements at that date retrospectively. Anecdotal evidence is that most entities are waiting until the mandatory adoption date.

FRS 105

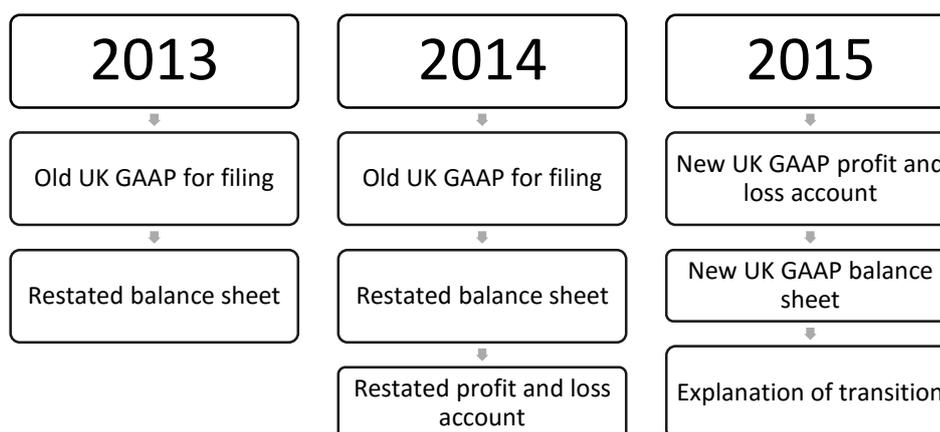
It is important to note that FRS 105 can be adopted NOW as early adoption is available from the date of approval by FRC (16th June 2015). Accounts for years ended on or after 31 December, which are due to be filed on or before 30 September 2015, if not yet completed, can be prepared under FRS 105. Indeed there appears to be nothing to stop accounts which are overdue from being completed under FRS 105, provided of course that they are for periods ending on or after 30th September 2013!

Requirements at the date of transition

As noted FRS 102 Section 35 and FRS 105 Section 28 require an entity to restate its balance at the date of transition. In addition the financial statements for that comparative period have to be restated to provide the comparative figures in the first FRS 102 or FRS 105 accounts.

The basic approach to restatement is to prepare the financial statements as they would have been had the new standard been complied with in the past.

This can be illustrated as follows:



The effect of any measurement / valuation changes is reflected in the opening balance on retained earnings or other appropriate category of equity.

There is no requirement to present the opening statement of financial position within the financial statements under FRS 102. There would be on the adoption of IFRS.

FRS 102 **requires** a company to explain the effects of transition, FRS 102 for small entities **recommends** a company to include an explanation and FRS 105 is silent on the subject.

Exceptions and exemptions

The general provisions referred to above are subject to various:

- (a) **Exceptions** – situations in which items **must not** be restated. These are included in FRS 102 35.9 and FRS 105 28.9.

- (b) **Exemptions** – situations in which items **need not** be restated. These are included in FRS 102 35.10 and FRS 105 28.10. In the Accounting Standards Checklists, the transitional exemptions are highlighted.

FRS 102 Section 1A additional transitional exemptions

There are three important transitional exemptions for small entities adopting FRS 102 for periods commencing before 1 January 2017, whereby the company need not restate the accounts at the date of transition and thus includes the comparative figures under old GAAP. It then restates the opening balance at the start date of the first period under FRS 102, and makes any adjustment against opening equity. The exemptions are:

- (a) Financial instruments at fair value;

Unless the entity previously included financial instruments at fair value, it is not required to obtain a fair value at the date of transition. It is however required to obtain one at the beginning and end of the first period under FRS 102.

- (b) Transactions with a financing element with a related party;

This could be important in practice as a small entity is not required to compute the present value at the date of transition. It is required to compute it at the beginning of the first period under FRS 102, but can use the facts and circumstances at that date to compute the present values. This would allow, for example, an interest free loan with a fixed repayment date to be renegotiated as due on demand before 1 January 2016. There would therefore be no accounting adjustments required.

- (c) Share based payments.

How will this work in practice?

Introduction

The following table outlines the various options available, together with an indication of which option a typical entity in each category will elect for.

	EU adopted IFRS (Note 1)	FRS 101 (Note 2) (Note 3)	FRS 102	FRS 102 reduced disclosure (Note 2)	FRS 102 Section 1A <i>small entities</i> (Note 4)	FRS 105 (Note 5 & 6)
Listed entity						
Group	Must	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Stand-alone (e.g. VCT)	Option	<input checked="" type="checkbox"/>	Option	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Large or medium unlisted						
Group	Option	<input checked="" type="checkbox"/>	Option	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Stand-alone	Option	<input checked="" type="checkbox"/>	Option	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Parent or subsidiary included in publicly available group accounts						
IFRS group accounts (Note 7)	Option	Option	Option	Option	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Non-IFRS group accounts (Note 8)	Option	Option	Option	Option	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Small entity						
In stand-alone accounts	Option	<input checked="" type="checkbox"/>	Option	<input checked="" type="checkbox"/>	Option	<input checked="" type="checkbox"/>
In group accounts (Note 9)	Option	<input checked="" type="checkbox"/>	Option	Option	Option	<input checked="" type="checkbox"/>
Micro-entity (Note 10)	Option	<input checked="" type="checkbox"/>	Option	<input checked="" type="checkbox"/>	Option	Option

The key to the table is as follows:

- This option is not available, for example because a plc cannot qualify as small, the reduced disclosure option can only be used in stand-alone accounts, and not group accounts etc.

Option – this option is available

Option – this is the option that the entity is expected to adopt.

Option – this option may be more attractive for some entities than the one we would normally expect them to adopt, and therefore should be considered. For example, a parent or subsidiary which can use FRS 101 may be better off using FRS 102 given the number of disclosures required by FRS 101 or because a lower tax liability or a stronger balance sheet results.

Note 1 - **IFRS** New UK GAAP does not require any entities to move to IFRS, which were not required to do so before. Indeed, IFRS remains mandatory only for the group accounts of listed companies. IFRS remains an option for most entities, but, in practice it is considered very unlikely that a small company would ever wish to adopt IFRS, because of the relative complexity and number of disclosures. The only possible justification for preparing accounts under IFRS would be where there was a commercial reason such as customers or suppliers require IFRS information, or perhaps in anticipation of a float. IFRS may not be used by charities.

Note 2 - **FRS 101** and **FRS 102 reduced disclosures**. These options are only available to qualifying entities i.e. parents and subsidiaries which are included in publicly available consolidated accounts and where the conditions have been complied with. They are not available in the group accounts themselves.

Note 3 - **FRS 101** is based on IFRS but with UK presentation and disclosure. Technically, therefore, it represents UK GAAP, although the accounting profit is likely to be equivalent to the profit included in IAS accounts. It is only likely to be relevant for a UK company included in group accounts prepared under IFRS.

Note 4 - **FRS 102 Section 1A small entities**. Given that the measurement and recognition principles of FRS 102 Section 1A *small entities* are identical with those under full FRS 102 and there are fewer presentational requirements and disclosures, we presume that those small entities which are not eligible to use FRS 105, or choose not to use FRS 105, will not use full FRS 102 but will use FRS 102 Section 1A *small entities*. Note that in practice a small company will have two options under company law in which to apply FRS 102 Section 1A *small entities* – full accounts or abridged accounts.

Note 5 - **FRS 105** is only be available for micro-companies. We consider it can be used as the basis for computing the taxable profit for unincorporated businesses.

Note 6 - Very small unincorporated businesses (but not LLPs) may elect to use the cash basis of accounting, in which case GAAP is irrelevant!

Note 7 - When IFRS became mandatory for listed groups, many parents and subsidiaries continued to prepare their individual statutory accounts under old UK GAAP. They now have to change. One of the attractions of FRS 101 is that a company no longer needs to prepare two sets of accounts, a statutory set under UK GAAP and a consolidation pack under group GAAP. This will be particularly important where group GAAP is IFRS, although it is possible that moving from old UK GAAP to FRS 102, rather than FRS 101, will be more attractive. This may be because there are more disclosures under FRS 101 than FRS 102 reduced disclosure, or the profit or balance sheet give a better result!

Note 8 - **FRS 101** There is no requirement for the group accounts to be prepared under IFRS for a parent or subsidiary to adopt FRS 101. However, FRS 101 is unlikely to be attractive where group GAAP is not IFRS. For example, were a UK subsidiary of a US parent to adopt FRS 101, it would have to prepare its accounts under the equivalent of IFRS and still have to produce a second set of accounts as a consolidation pack under US GAAP. We therefore expect such entities to move to FRS 102 reduced disclosure.

Note 9 - **Small company included in group accounts** A small company which is included in group accounts could use FRS 102 reduced disclosures. However the reduction in disclosures is more significant under FRS 102 Section 1 A *small entities*. We would therefore expect the company to adopt Section 1A. The information for the notes may need to be obtained for inclusion in the group accounts.

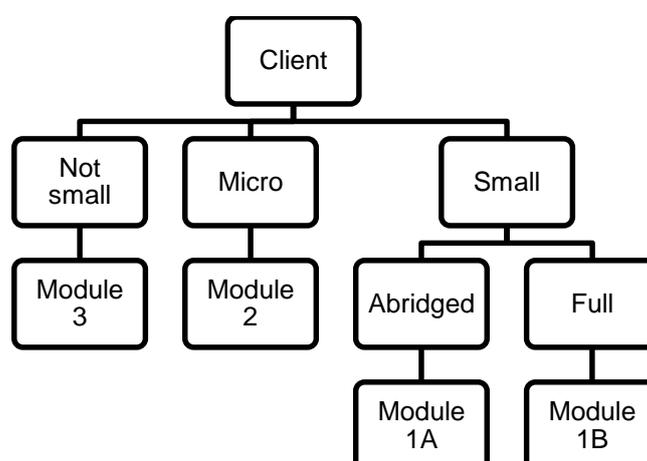
Note 10 - A micro-entity which wishes to use fair values may not use the micro-entity regime and hence may not use FRS 105. Such an entity will therefore opt for FRS 102 for small entities.

The revised SCR Reporting structure

Based on the above analysis we consider that most users will be able to classify their clients into one of the four following categories:

- (a) Those which do not qualify as small entities and which will therefore be required to adopt FRS 102. This assumes that they do not voluntarily opt for IFRS nor are required to adopt FRS 101.
- (b) Those which qualify as micro-entities and who will opt for FRS 105. Although, currently, the uptake in the use of micro-entity accounting has been very slow the changes introduced by FRS 105 are expected to make it the default for most-micro-entities
- (c) Those companies which qualify as small and previously used FRSSE. This includes micro-entities which do not comply with FRS 105. These entities are likely to adopt FRS 102 for small entities. They will further subdivide into:
 - (i) Those who prepare full accounts under the Small Company Regulations; and
 - (ii) Those who prepare abridged accounts under the Regulations.

We have developed a new overall checklist which can be used for individual assignments to identify which of the four options outlined above apply and have restructured SCR Reporting into 4 Modules which correspond with the above classification.



Each module is structured in exactly the same way:

A. What you need to know

This section gives an overview of the applicable legal and regulatory background.

B. Accounting Standards Summary

Structured as a checklist which can be used on individual assignments or be available for reference as an *aide-memoir* this gives an overview of the measurement and recognition criteria for each item typically found in financial statements of a small company. The disclosure and presentation issues are dealt with in Section C.

C. Accounts Disclosure Checklist

The checklists are summaries, and should be used only as an *aide-memoir*. They are intended to be completed on an individual audit or accounts preparation assignment.

D. Illustrative company accounts

The specimen annual accounts illustrate compliance with the disclosure requirements included in the relevant checklist. They have been annotated to illustrate key changes from those prepared under old UK GAAP

E. Transition Checklist

This final checklist is intended to be used in the first year of application of new UK GAAP.

In addition, the SCR Guide to new UK GAAP supplements each module, dealing as it does with an overview of new UK GAAP comparing it with old GAAP and highlighting differences between FRS 102 and FRS 105

Timetable for issuing revised materials

Given the fact that FRS 105 is available for use now, and can therefore be used for 31 December 2014 year ends which are due for filing by 30 September 2015, Module 2 has been issued at the same time as this bulletin and is available for downloading on www.smallcompanyreporting.co.uk.

The other modules will be published by the end of October 2015 as they are generally not applicable until periods ending on or after 31 December 2015. Since they are effective for periods **commencing on or after 1 January 2015**, they do have to be applied for short accounting periods. Users who have short accounting periods to complete before the updated modules have been released should please contact us and we will seek to help.

The existing documents checklists and illustrative accounts continue to apply for earlier accounting periods.

Publications and subscriptions

SCR Reporting Bulletin is a quarterly bulletin dealing with accounting and auditing matters affecting the small company. It is available as part of the subscription for users of SCR Procedures (previously known as Small Company Reporting Procedures Manual) or SCR Reporting (previously known as Small Company Reporting). It is also available as a separate subscription.

With effect from 1 July 2015 the two manuals, plus the sister publication SCR Charities, are published in a members' section of the website www.smallcompanyreporting.co.uk and are available to download in Word or PDF format. When changes are made, they are advised by e-mail, on the website and in the next Bulletin.

Subscription enquiries and administration queries should be addressed to: M Jackson, Director, Small Company Reporting Ltd, Albion House, Albion Street, Hull, HU1 3TE. **Telephone** 01482 794 654 **E-mail** info@smallcompanyreporting.co.uk

Technical enquiries

Although Small Company Reporting Limited does not have the resources to provide a *hotline* for readers, we respond to technical enquiries where possible. Matters of general interest form the basis of **points arising** in the quarterly bulletin. Enquiries in relation to any technical items in this Bulletin, or from use of the manuals should be addressed to Bill Telford, Technical Director, Small Company Reporting Limited, Albion House, Albion Street, Hull, HU1 3TE or by e-mail to bill@smallcompanyreporting.co.uk

Update instructions

There are no changes required to existing manuals. As noted above SCR Reporting can continue to be used for periods commencing before 1 January 2015. They will be superseded by the new modules for periods commencing on or after 1 January 2016. If you have not already subscribed, or renewed your subscription why not do so now. The current prices are £100 + VAT for each of the three manuals separately, or £229 + VAT for all three.

Appendix 1: Illustration of building block approach to the use of formats in company law

The following items are taken from the trial balance of Annabelle Ltd at the balance sheet date:

	Debit	Credit
Patents and trademarks	1,000	
Goodwill	900	
Land and buildings	1,200	
Plant and machinery	2,800	
Other fixtures and fittings, tools and equipment	700	
Raw material and consumables	300	
Work in progress	850	
Finished goods for resale	550	
Trade debtors	870	
Prepayments	250	
Accrued income	600	
Bank and cash	220	
Trade creditors		650
Other creditors		150
Accruals		370
Deferred income		400
Share capital		1,000
Share premium account		1,000
Profit and loss account		6,670

Consider the information required to be disclosed if:

- (a) Annabelle Ltd is a micro-entity;
- (b) Annabelle Ltd is a small company and is permitted to produce an abridged balance sheet;
- (c) Annabelle Ltd is a large or medium sized company.

Comments on illustration 4

The reductions in information required for small and micro-companies referred to above are based on the building block approach applied by the Accounting Directive, based on three categories of format headings initially introduced into UK company law in the 1981 Companies Act and subsequently updated, including in the recent revisions to the regulations. Given that new UK GAAP requires the use of the formats for all true and fair or equivalent accounts, it is worth considering the underlying principles in legislation

Each format heading is prefixed by one of the following:

- (a) *alphabetic character (e.g. B - Fixed Assets),*
- (b) *a Roman numeral breaking down the components of an item with an alphabetic prefix (e.g. I - Intangible fixed assets, II - Tangible fixed assets and III - Investments); or*
- (c) *an Arabic numeral breaking down the components of an item with a Roman numeral prefix (e.g. 1 - Land and buildings, 2 - Plant and machinery).*

There are three important issues arising from the changes noted above:

- (a) *The formats themselves have been updated for the new Accounting Directive;*
- (b) *The categorisations of companies outlined above defines the level of detail required as follows:*
 - (i) *The formats for micro-companies included in Section C of the Regulations include only items with an Alphabetic designation;*
 - (ii) *The formats for small companies add items with a Roman numeral designation to the alphabetic designated items if they prepare abridged accounts, and items with a numerical prefix if they prepare full accounts. Note that these formats have fewer headings than those for large and medium sized companies ;*
 - (iii) *Large companies include all three;*

- (c) *There was an initial apparent conflict between the terminology of the formats and FRS 102. For example, Section 13 FRS 102 refers to inventories and Section 17 to Property, plant and equipment. The relevant format headings are stocks and tangible assets respectively. Both are prefixed by Roman Numerals which must be used in the form and in the order prescribed by the Act. On a strict interpretation of the law, the latter titles may not be used.*

Initial advice was that the format headings should be used rather than the FRS 102 headings until such time as the FRC or BIS give alternative guidance. However the revisions to FRS 102 open the door to the use of FRS 102 terminology more widely.

The three answers below clearly indicate the building block approach. The micro-company is only required to include those items with an alphabetic prefix. The small company preparing abridged accounts only needs add the items Roman numeral prefix. Finally, the large or medium sized company must add the items prefixed by Arabic numerals and include all of the applicable balance sheet format items.

Part (a) Micro-company balance sheet

The micro-company is only required to include those items with an alphabetic prefix.

Fixed assets		6,600
Current assets	2,790	
Prepayments and accrued income	850	
Creditors: amounts becoming due and payable within one year	<u>(800)</u>	
Net current assets		2,840
Accruals and deferred income		<u>(770)</u>
Total assets less current liabilities		<u>8,670</u>
Capital and reserves		8,670

Note 1 - A company which is not a micro-entity has a choice to include prepayments and accrued income within current assets as debtors due within one year or as a separate line. There is no such flexibility within micro-accounts.

Note 2 – As in note 1, a micro-entity does not have the flexibility available to other entities to include accrued expenses and deferred income within creditors.

Note 3 – The formats require aggregate amounts falling due within one year and after one year must be shown separately. This could be done by the use of sub-totals on the balance sheet or by way of note.

In practice, this means that a single figure is shown on the balance sheet for each of these format headings but the underlying numbers are not shown, either on the balance sheet or in the notes, as they would be for a larger company.

The only notes required for a micro-company are advances to directors and guarantees and commitments not on the balance sheet. All that is filed at Companies House is the balance sheet and the two notes.

Given that these are the statutory accounts for the company they are what is submitted to HMRC! Why are so few micro-company accounts prepared in practice?

As outlined in Appendix 2 chapter 31 below, the introduction of FRS 105 for micro-companies has made the preparation of micro-company accounts even more attractive.

Part (b) Abridged balance sheet small company

A small company electing to prepare abridged accounts is only required to include items with alphabetic or roman numeral prefixes.

Note that we have included prepayments within current assets under other debtors and accrued income as a separate line. Similarly we have included accruals as creditors due within one year under other creditors and deferred income as a separate line in the format. We could just as easily have included

both the prepayments of £250 and the accrued income of £600 within current assets or prepayments and accrued income. Similarly we could have included the accruals of £650 and deferred income of £370 within creditors or accruals and deferred income!

Fixed Assets

Intangible assets	1,900	
Tangible assets	4,700	
		6,600
Current assets		
Stocks	1,700	
Debtors	1,120	
Cash at bank and in hand	220	
	3,040	
Accrued income	600	
Creditors: amounts becoming due and payable within one year	(1,170)	
Net current assets		2,470
Deferred income		(400)
Total assets less current liabilities		8,670
Capital and reserves		
Called up share capital		1,000
Share premium account		1,000
Profit and loss account		6,670
		8,670

Abridged accounts are only available if approved by all the shareholders every year. Note that if this abridged format is adopted the supporting notes for the items not disclosed e.g. the fixed asset not with its analysis of land and building, plant and machinery etc. are not required.

Under accounting standards there will be no difference between the items in the accounts, and therefore accounting or taxable profit. The abridgement only reduced information to shareholders, on the public record as these are the accounts filed at Companies House, and to HMRC.

The question for the taxpayer and tax advisers is whether or not to seek shareholder approval!

Of probably more importance than the reduced information available from the presentation in the balance sheet is the fact that there will be no requirement for notes relating to line items not on the balance sheet!

Part (c) A small company which does not opt for abridged accounts

All of the format headings must be included. Note however that there are not as many format headings as there are for medium size companies.

In practice those items with Arabic prefixes (those underlined) are usually relegated to the notes.

Fixed Assets

Intangible assets

<u>Goodwill</u>	900	
<u>Other intangible assets</u>	1,000	
		1,900

Tangible assets

<u>Land and buildings</u>	1,200	
<u>Plant and machinery etc.</u>	3,500	
		4,700
		6,600

Current assets

Stocks		
<u>Stocks</u>	1,700	
<u>Payments on account</u>		
		1,700

<i>Debtors</i>			
<u>Trade debtors</u>	870		
<u>Other debtors</u>	250		
			1,120
Cash at bank and in hand		220	
			3,040
Accrued income		600	
<i>Creditors: amounts becoming due and payable within one year</i>			
<u>Trade creditors</u>	(650)		
<u>Other creditors</u>	(420)		
			(1,070)
Net current assets			2,470
Total assets less current liabilities			9,070
Deferred income			(400)
			8,670
<i>Capital and reserves</i>			
Called up share capital			1,000
Share premium account			1,000
Profit and loss account			6,670
			8,670

Part (d) Large or medium sized company balance sheet

All of the format headings must be included. In practice those items with Arabic prefixes (those underlined) would be relegated to the notes.

Fixed Assets

Intangible assets

Concessions, patents, licences, trade marks and similar rights 1,000

Goodwill 900

1,900

Tangible assets

Land and buildings 1,200

Plant and machinery 2,800

Fixtures, fittings, tools and equipment 700

4,700

6,600

Current assets

Stocks

Raw materials and consumables 300

Work in progress 850

Finished goods 550

1,700

Debtors

Trade debtors 870

Prepayments 250

1,120

Cash at bank and in hand

220

3,040

Accrued income

Creditors: amounts becoming due and payable within one year		600	
<u>Trade creditors</u>	(650)		
<u>Other creditors including tax and social security</u>	(150)		
<u>Accruals</u>	(270)		
		<u>(1,070)</u>	
Net current assets			<u>2,470</u>
Total assets less current liabilities			<u>9,070</u>
Deferred income			<u>(400)</u>
			<u>8,670</u>
Capital and reserves			
Called up share capital			1,000
Share premium account			1,000
Profit and loss account			<u>6,670</u>
			<u>8,670</u>

Consider the case of intangibles, often a contentious issue in tax.

- (a) A micro-company does not even have to disclose that it has intangible assets, as it simply needs a one line item for fixed assets. There is no requirement for a note showing the movement in fixed assets during the year. Nor is there a requirement for an accounting policy note.
- (b) A small company preparing abridged accounts is required to show the total of intangible assets and tangible assets separately on the face of the balance sheet but is not required to show the components of those fixed assets such as goodwill or other intangibles. The fixed asset movement note, which is one of the mandatory notes, would only show the movement in total intangibles and tangibles.

An accounting policy note is required.

There are no notes disclosing items in the profit and loss account, other than a requirement to disclose "the amount and nature of any individual items of income or expenditure of exceptional size or incidence."

- (c) A large or medium sized company would show separately the amount of intangibles and tangibles on the face of the balance sheet and then give an analysis of each category in the notes over the items designated with an Arabic prefix. The notes would show the movements on the individual asset categories.

The question for the tax practitioner or accountant advising the taxpayer is whether to take advantage of the reductions in information requirements available. HMRC cannot ask on a routine basis for information which is no longer required by company law or accounting standards. That is not to say that they may not initiate an enquiry into the self-assessment returns in the usual way. The fact that HMRC will not be able to carry out as thorough a risk assessment by reading the accounts may lead to an increase in the number of such enquiries, but the increased risk of an enquiry is unlikely to outweigh the perceived benefit of disclosing less information.

This is particularly relevant for micro-entities since there is no requirement for any notes other than advances and credits to directors and commitments not on the balance sheet. Most clients and advisers will welcome the fact that disclosure of related party transactions is not required, as this note can be time consuming to produce and can flag transactions or relationships which might prompt queries from HMRC, for example into possible transfer pricing issues. Additionally, as we will see in the next chapter, accounting standards for micro-entities will be simpler to apply for micro-entities and this should make them more attractive to taxpayers and their advisers. For many, the fact that deferred tax is not required will be sufficiently attractive in itself to warrant the use of the micro-entity option.

The decision as to whether to prepare abridged accounts for a small company is more nuanced, and also may be more difficult to arrange because of the need to get unanimous agreement of all shareholders.

Before leaving this section it is essential to notice that these changes in presentation do not change the need to identify the underlying detail in terms of preparing the accounts and tax computation. Therefore a micro-entity has to compute stock at the lower of cost and net realisable value, debtors are after provision for bad and doubtful debts and adjustments need to be made for accruals and prepayments. Having computed stock, debtors, prepayments and bank and cash figures, a micro-entity simply then shows a single figure for current assets.

Appendix 2: Company accounts overview checklist

Client:				Period End:			
Completed by:		Date:		Reviewed by:		Date:	
Objective:	The purpose of this checklist is to determine options available under new UK GAAP and company law and confirm eligibility, where appropriate. <i>This checklist applies to periods commencing on or after 1 January 2015 or when an entity is considering early adoption</i>						
Actual	Current year			Previous year		Previous year	
Turnover							
Gross assets							
Employees							
Step 1	Is the company a member of a group included in consolidated accounts? If YES – complete group checklist overleaf If NO – proceed to step 2						YES / NO
Step 2	Is the company eligible¹ to use, and wishes to use, the small companies' regime under CA 2006?						YES / NO
	Criterion	Turnover	Gross assets	Employees			
	No more than ²	£10,200,000 ³	£5,100,000	50			
	If NO – FRS 102⁴ must be used and the company must comply with the large business and group regulations If YES - proceed to Step 3						
Step 3	Is the company eligible to and wishes to use the micro-entities' regime?						YES / NO
	Criterion	Turnover	Gross assets	Employees			
	No more than ⁵	£632,000 ⁶	£316,000	10			
	Ineligible companies: An investment undertaking, financial holding undertaking, credit institution, insurance undertaking, charity (see S 384B(1) CA 2006) If YES – Follow FRS 105 and the micro-entity regulations included in the Small companies and group regulations. Then go to Step 5 . If NO –Go to Step 4						
Step 4	Does the company wish to prepare abridged accounts and if so, has it received the unanimous consent of shareholders for the current year, or is expected to do so?						YES / NO
	If NO – Follow FRS 102 Section 1A and the full presentation requirements of the small companies' regulations. Then go to step 5. If YES – Follow FRS 102 Section 1A and abridgement provisions of the small company regulations. Then go to step 5.						
Step 5	Does the entity wish to take advantage of the exemption not to file the directors' report (if required) and profit and loss account?						YES / NO
	If YES – file accounts as prepared for shareholders. If No – file balance sheet and notes only. ⁷						

¹ To qualify entity must meet size criteria (see 2 below) and not be an ineligible company i.e. not a public company, authorised insurance company, a banking company, an e-money issuer, a MiFID investment firm or a UCITS management company or a member of an ineligible group

² To qualify the company must meet the criteria for at least 2 successive years. A new company will qualify if it meets the criteria in the first year. To fail to qualify it must fail to meet the criteria for the current and preceding periods. A parent must head a small group.

³ Where the reporting period is more or less than a year, the turnover limit is adjusted on a pro-rata basis

⁴ This checklist assumes that a company will not voluntarily adopt IFRS.

⁵ There is a similar two year test for micro-entity qualification to that for small companies referred to above. A parent must head a small group and meet the micro-size criteria.

⁶ As with the small company test, where the reporting period is more or less than a year, the turnover limit is adjusted on a pro-rata basis

⁷ If the company is a small company it must disclose that directors' report and profit and loss account have not been filed, if it has been audited, information about auditor's report as required by regulation must be included with balance sheet and notes.

Company accounts overview checklist (continued)

Client:		Period End:	
Completed by:	Date:	Reviewed by:	Date:
Objective:	The purpose of this checklist is to determine options available under new UK GAAP for UK companies included within consolidated accounts. <i>This checklist applies to periods commencing on or after 1 January 2015 or when an entity is considering early adoption.</i>		
Step 1	Is the company included in a group preparing consolidated accounts under IFRS ⁸ ?		YES / NO
	If YES – the company should consider whether FRS 101 is more appropriate than FRS 102 . If FRS 102 is more appropriate than FRS 101 , the reduced disclosure options may be applied in the separate accounts of the parent? ⁹ Go to step 2. If NO – Go to step 2		
Step 2	Is the company a parent preparing consolidated accounts?		YES / NO
	If YES - FRS 102 should be applied in preparing the consolidated accounts and the reduced disclosure options applied in the parent company's own accounts. If NO – go to step 3		
Step 3	Is the company eligible to and wishes to use the small companies' regime? <i>For eligibility see footnotes on previous page</i>		YES / NO
	If NO – FRS 102 should be used with the reduced disclosure options in FRS 102. If YES – See step 4		
Step 4	Does the company wish to prepare abridged accounts and if so, has it received the unanimous consent of shareholders for the current year, or is expected to do so?		YES / NO
	If NO – Follow FRS 102 Section 1A and the full presentation requirements of the small companies' regulations. Then go to step 5. If YES – Follow FRS 102 Section 1A and abridgement provisions of the small company regulations. Then go to step 5.		
Step 5	Does the entity wish to take advantage of the exemption not to file the directors' report (if required) and profit and loss account?		YES / NO
	If YES – file accounts as prepared for shareholders. If No – file balance sheet and notes only. ¹⁰		

⁸ Although FRS 101 is an option for a company included in group accounts prepared on a basis other than IFRS, it is not expected to be used, unless the group accounts are under IFRS, and even then FRS 102 may be easier to apply or otherwise more advantageous.

⁹ Where the parent is a small company, although the company is eligible to use the reduced disclosure options within FRS 102, there are fewer disclosures under FRS 102 Section 1A *small entities*. The checklist therefore assumes that this is the option the company will choose.

¹⁰ If the company is a small company it must disclose that directors' report and profit and loss account have not been filed, if it has been audited, information about auditor's report as required by regulation must be included with balance sheet and notes.

Appendix 3: Are micro-entity accounts appropriate for my client?

Introduction

Very few people have to date prepared micro-company accounts. In our experience people don't use micro-company accounts for one of three reasons:

- (a) The purist argument – the accounts aren't "real accounts"? They don't give a true and fair view;
- (b) The commercial argument – I am worried about the reduction in fees the clients will want because they get much less information;
- (c) The "better the devil you know" argument – the client has been used to getting FRSSE accounts, I have been used to preparing them and I am worried that HMRC will be more likely to open an enquiry if I prepare micro-company accounts as they will be getting less information than before.

We fear that there is also still a remnant of the "I didn't know you could use micro-company accounts" response, while there also some who say "my software can't produce them." The former is embarrassing, both for the individual and, to some extent, the professional bodies who have not get the message across about the availability, and suitability of micro-entity accounts. As far as software is concerned, our understanding is that most, if not all software suppliers now have a micro-entity template so this latter point may have been applicable in the early days, but not now.

Why the purist argument is a red herring

The building block approach adopted by the EU Accounting Directive is based on a think-small first basis, and takes into account the information need of users. It is implicit in the micro-entity regulations that the principal users of the statutory accounts are the shareholders, and as they are likely to be the directors, they already know all there is to know about the financial performance and position of the company from the management accounts. They do not rely on or use statutory accounts for making decisions.

It is clear to accountants that micro-entity accounts are not true and fair as we have known it over the years – and how could they be without an accounting policies note – but, if company law presumes that they are, why should companies not use this fact to simplify their accounts? Why should we insist on including in the financial statements information which shareholders are not interested in, or already know and which then disappear from the abbreviated accounts filed at Companies House? Especially when one of those notes is often a source of controversy, and for which clients don't like to provide information. This note is, of course the related party transactions note! Interestingly the fact that there is no related parties note appears as part of the rebuttal of each of the three arguments, justifying why a micro-entity should use micro-accounts.

Why there is no real risk that the firm's fees will fall significantly

Old UK GAAP

It should be emphasised that micro-entity accounts are simpler for **all** micro-entities to prepare, even under old UK GAAP, although for **most** there will be no difference in profit or asset values, as, in general, the recognition and measurement criteria in FRSSE are the same for all small companies. The important exemption is, of course, the prohibition in company law on the use by a micro-entity of fair values.

To prepare the information from which micro-company accounts are prepared companies follow the requirements of FRSSE. Stock is included at the lower of cost and net realisable value, provision is required for bad and doubtful debts, accruals and prepayments calculated and adjusted for and depreciation and tax calculated and recorded. The cost of preparing the trial balance is the same whether the micro-company is following the micro-companies' regime or not.

Therefore the only time savings for a typical micro-entity preparing accounts under the micro-entities regime are those relating to drafting and checking all of the other notes no longer required, including related party identification and disclosure.

It should be possible to explain this to the client, and, therefore, for the client to accept a fee very much in line with previous years as the work remains the same.

FRS 105

Because of the simplifications introduced by FRS 105, there will be less work to do under FRS 105 than there was under FRSSE. For example there is no deferred tax provision required, but the reduction in time – and hence fees – is unlikely to be significant.

There is, we would argue, a bigger risk to a firm which does not use micro-entity accounts. This is the risk that competitors will target clients, pointing out that as they are not using micro-entity accounts, they producing more information than is required, and possibly paying too much in fees. There is evidence that such marketing is happening.

Third parties and micro-entity accounts

General

Earlier we referred to the shareholders as the principal users of the accounts of micro-entities. We would argue that banks and other lenders to such entities do not rely on statutory accounts. They often have access to budgets and management accounts and, in many cases, have security over the assets of the company and directors' personal guarantees.

What about the argument that the use of micro-entity accounts will damage a company's credit rating?

Since the Companies Act 1981 introduced the ability to file abbreviated accounts, credit reference agencies have only had access to a balance sheet and limited notes for most small companies. The use of micro-entity accounts does not really change significantly what is on the public record.

HMRC

Finally what about HMRC? In our view, this is the most compelling reason why most small companies who are eligible to do so should have been preparing micro-entity accounts for the last eighteen months.

Micro-company accounts are acceptable for tax purposes and HMRC cannot open an enquiry just because a company has changed from full FRSSE accounts to micro-entity accounts. An inspector of taxes cannot ask, as a matter of course, for information which BIS have said is no longer required.

Yes, HMRC have less information than they used to, but it is little different from the level of information available to unincorporated businesses of similar size. There must therefore be a risk that some enquiries are opened unnecessarily, and some enquiries which should be undertaken are missed. To disclose the least information possible is generally considered sensible. Note this does not change any of the general disclosure requirements imposed on taxpayers or rights of enquiry of HMRC!!

Which brings us back to the related party transactions note. Why should a company send information to HMRC on matters which might give rise to enquiries about matters such as transfer pricing, arising from disclosures of related party transactions, when it does not have to? Under FRS 105 there is no need to disclose dividends payable to directors, or related parties of directors and other information, which as well as being already known to the directors and shareholders, might result in additional queries from HMRC.

Note however, that advances to directors are disclosable, but not advances by directors.

When would small company GAAP be more appropriate than micro-entity accounting?

Old UK GAAP

As can be seen from the above analysis, we think that the starting point is that it will usually be appropriate for a micro-entity to use micro-entity accounts. Under old GAAP that would be using the amended FRSSE. The full FRSSE would only be used where it produces a better profit or balance sheet, however the client would perceive it.

Illustration

Anne Ltd has an investment property which cost £300,000. It currently has a market value which is equivalent to fair value of £500,000 and on which it has borrowings of £400,000.

- (a) How should this be dealt with under existing UK GAAP? And

(b) What would be the impact on the adoption of new UK GAAP?

Comments on illustration

Part (a) Old UK GAAP

If micro-entity accounting were used, the investment property would be reduced to cost of £300,000, and depreciation would need to be provided. This would result in a potentially insolvent position, whereas under FRSE it is required to use fair values and the balance sheet would show a solvent position. In such a situation Anne would be unlikely to opt to use the micro-entity regulations.

Part (b) New UK GAAP

There is no change and Anne might prefer to use the small companies' regime.

New UK GAAP

We consider that most micro-entities will continue to find that the use of the simpler accounting in FRS 105 is advantageous and therefore it will probably become the default standard for such companies. However, this will not always be the case and users should assess whether the benefits of simpler accounting are outweighed by the differences in, say, taxable profit that would be achieved using FRS 102.