

AAT RESPONSE TO THE FINANCIAL REPORT COUNCIL'S CONSULTATION DOCUMENT "ACCOUNTING STANDARDS FOR SMALL ENTITIES – IMPLEMENTATION OF THE EU ACCOUNTING DIRECTIVE"

1 EXECUTIVE SUMMARY AND OVERVIEW

- 1.1 AAT has responded to the questions in the Financial Reporting Council's (FRC) consultation document on "Accounting standards for small entities - Implementation of the EU Accounting Directive" (condoc) and has additional observations which the FRC may wish to consider prior to the issuance of Exposure Drafts.
- 1.2 The issue relating to financial statement disclosures required for small entities has been the subject of much debate over the years. AAT recognises that disclosures for small entities must be balanced, comprehensive, proportionate to the size of the reporting entity and at the same time they should not dilute the meaningfulness of the financial statements taken as a whole.
- 1.3 AAT recognises that the act of 'boiler plating' (i.e. the use of standard disclosures) is still widespread within financial statements – particularly among smaller entities where directors are often confused as to the levels, and content, of disclosures required in order for the financial statements to give a true and fair view.
- 1.4 The EU proposals to make specific and limited disclosures in small entities' financial statements will, in the opinion of AAT, further accentuate this confusion where additional disclosure requirements, over and above the mandatory requirements, are required to enable a true and fair view to be achieved because judgement will be required.
- 1.5 The general consensus noted by AAT is that the Micro-Entities' legislation is proving to be somewhat controversial within the profession. While many accountants broadly support the legislation, there are still many questioning the deeming provisions enshrined within the legislation which state that financial statements prepared under the Micro-Entities' legislation are deemed to give a true and fair view as from a common sense perspective this is clearly not the case.
- 1.6 AAT is supportive of the proposals in the consultation document and believes they offer a framework that will allow a small entity preparing financial statements to make relevant disclosures which are balanced and proportionate.

2 RESPONSE TO QUESTIONS FOR RESPONDENTS

Question 1

Do you agree with the proposal to develop a new accounting standard, the *Financial Reporting Standard for Micro-entities (FRSME)*, for entities taking advantage of the micro-entities regime (see paragraph 2.4)? If not, why not?

- 2.1 AAT agrees that this regime should be contained within a separate standard. Including the requirements for micro-entities within the proposed Section 1A of FRS 102 would be cumbersome and potentially confusing for preparers of micro-entity financial statements (as is currently the case with the current versions of the FRSSE).
- 2.2 In addition, AAT believes that because the micro-entities regime allows a qualifying entity the opportunity for significantly reduced disclosure requirements, it would be appropriate to segregate the financial reporting requirements for micro-entities from that of small companies that choose not to apply the FRSME or which do not otherwise qualify to apply FRSME in their financial statements.

Question 2

Do you agree with the proposed recognition and measurement simplifications that are being considered for the FRSME (see paragraph 2.6(b))? If not, why not? Are there any further areas where you consider simplifications could be proposed for micro-entities?

- 2.3 AAT recognises, and agrees, that relatively few micro-entities are likely to have defined benefit pension schemes 2.6 (b) (condoc) or derivative financial instruments.
- 2.4 AAT supports the proposed recognition and measurement simplifications that are being considered for the FRSME and considers that many of its members will be supportive of the simplifications – for example repealing the requirement to account for deferred taxation (2.6 (b)(ii), condoc). However, AAT believes the issue concerning deferred taxation (2.6 (b)(ii), condoc) requires further clarification (see also 2.5, below). The proposals do not require micro-entities to account for deferred taxes and therefore any deferred tax liabilities will be reversed on first-time application of the FRSME.
- 2.5 In consideration of our comments in 2.4 (above) AAT believes that clarification as to whether reversals of deferred tax liabilities should be distributable to shareholders in the form of a dividend is required.

- 2.6 AAT has considered the requirements in *Tech 01/09 Guidance on the Determination of Realised Profits and Losses in the Context of Distributions under the Companies Act 2006*¹ issued by the Institute of Chartered Accountants of Scotland and the Institute of Chartered Accountants in England and Wales. Specifically, paragraph 3.17 refers to the concept of deferred tax in determining realised gains and losses. The paragraph states that a provision for deferred tax should generally be regarded as a realised loss and therefore its reversal would fall to be classed as a realised gain and hence distributable as a dividend on its reversal. AAT believes that specific clarification on this issue would be of benefit to users of the proposed FRSME.

Question 3

The accounting standard that is applicable to small entities (not just small companies) (i.e. currently the FRSSE) is being revised following changes to company law. Company law, which will limit the disclosures that can be made mandatory, may not apply to entities that are not companies. Do you agree that the accounting standard for small entities should continue to be applicable to all entities meeting the relevant criteria, not just small companies? This will have the effect of reducing the number of mandatory disclosures for all small entities, not just small companies (see paragraph 3.11). If not, why not?

- 2.7 AAT agrees that the accounting standard for small entities should continue to apply for all small entities, whether incorporated or not, as this will allow for simplicity and consistency in financial reporting.
- 2.8 We are concerned that if the requirements of the accounting standard and respective disclosure requirements for smaller entities do not apply to all entities under the scope of the standard, it would result in significant disparities in the financial statements for an unincorporated entity versus those of an incorporated entity. The resultant lack of consistency and comparability would be undesirable to investors and stakeholders who need consistency and comparability to make investment decisions.

¹ http://icas.org.uk/aa/tech_01_09_distributable_profits.pdf

Question 4

Do you agree that the FRSSE should be withdrawn and small entities should be brought under the scope of FRS 102, so that they apply recognition and measurement requirements that are consistent with larger entities, but with fewer mandatory disclosures (see paragraph 3.15)? If not, are there any areas where you consider there should be recognition and measurement differences for small entities and why?

- 2.9 AAT supports the withdrawal of the FRSSE on the grounds of the differences in certain accounting treatments in the FRSSE and in FRS 102 (see paragraph 2.11). AAT also recognises that, in any event, consequential amendments to the FRSSE (effective April 2008) were needed to apply existing company law requirements.
- 2.10 AAT questions the usefulness/appropriateness of the FRSSE (effective January 2015) in light of the standard's proposed very short lifespan. Notwithstanding this reservation concerning the FRSSE (effective January 2015), AAT is in full support of the proposals to bring small entities under the scope of FRS 102 by the inclusion of a Section 1A *Small Entities* within FRS 102.
- 2.11 AAT has identified a number of key accounting inconsistencies between FRS 102 and the FRSSE (effective April 2008 and January 2015) - most notably the accounting treatment of fair value fluctuations in investment properties, covered in 3.24 (a) (condoc), and the 'timing difference' approach in the FRSSE (effective April 2008 and January 2015) versus the 'timing difference plus' approach in Section 29 of FRS 102. We consider that bringing small companies under the scope of FRS 102 will both reduce these accounting treatment disparities and also the impact on the financial position and performance of a growing entity when it moves to 'full' FRS 102 in the future.

Question 5

FRED 50 Draft FRC Abstract 1 – Residential Management Companies' Financial Statements was issued in August 2013. After considering the comments received, the FRC publicised its intention to roll this project into the work required to implement the new EU Accounting Directive. Do you agree, in principle, with adding a new sub-section to Section 34 *Specialised Activities* of FRS 102 to address the principles of accounting by residential management companies (RMCs) (see paragraph 3.27)? If not, do you consider this unnecessary, or would you address the issue in an alternative way?

- 2.12 Based on internal discussion and without the canvassing of views from our wider membership, AAT agrees, in principle, with the suggested inclusion of Residential Management Companies as a sub-section to Section 34 as it appears to be the most sensible option.

Question 6

FRS 102 does not currently include all of the disclosures specified in company law. Other than in relation to the new small companies regime within FRS 102, it is not proposed that this will change. Do you agree that FRS 102 should not include all the disclosure requirements for medium and large companies from company law (see paragraph 4.6)? If not, why not?

- 2.13 The FRC is to be commended on its efforts in reducing the volume of UK GAAP from some 3,000 pages to 360 in the August 2014 edition of FRS 102. This significant reduction in volume makes the FRS very user-friendly and structured.
- 2.14 AAT supports the FRC's proposals not to include all the disclosure requirements for medium and large companies from company law. We consider that to have taken such an approach would have disproportionately increased the volume of FRS 102, potentially resulting in a lack of comprehension and reducing its user-friendliness. Should this requirement change, then any company law disclosures should be included within an Appendix to FRS 102, as opposed to within the main text of the FRS.

Question 7

Do you agree that, if UK and Irish company law is sufficiently flexible, FRS 101 should be amended to permit the application of the presentation requirements of IAS 1 *Presentation of Financial Statements*, rather than the formats of the profit and loss account and balance sheet that are otherwise specified in company law (see paragraph 5.4)? Do you agree that this will increase the efficiency of financial reporting within groups? If not, why not? Do you foresee any downsides to this approach?

- 2.15 AAT agrees that if company law permitted the use of IFRS formats in financial statements, FRS 101 should be consequently amended to reflect this.

- 2.16 Amending the requirements set out in FRS 101 would offer the opportunity for increased reporting within groups although the standard would still have to refer to the fact that financial statements prepared using IFRS formats are still UK GAAP financial statements so as to avoid any potential confusion among preparers.

3 CONCLUSION

- 3.1 AAT fully supports the proposals in the consultation document and also supports the need for small companies to make additional disclosures, over and above those contained in the proposed legislation, to enable the financial statements to give a true and fair view.
- 3.2 AAT agrees with the FRC's comments² concerning the challenge that small companies will be faced with in terms of dealing with additional disclosure requirements to achieve a true and fair view. However, the use of external accountancy services by small companies should help to mitigate this challenge considerably through the entity seeking advice from their accountant.
- 3.3 AAT considers that the standard needs to make it clear that entities should consider which disclosure notes are required and that they cannot just assume that the 13 notes required by law will be sufficient.

4 ABOUT THE AAT

- 4.1 The Association of Accounting Technicians (AAT) is pleased to take part in this opportunity to comment on the FRC's "Accounting standards for small entities – Implementation of the EU Accounting Directive".
- 4.2 AAT has over 49,800 Members and 80,000³ Students worldwide.
- 4.3 AAT has over 4,100 Members in Practice who provide accounts and tax services, including assisting companies to meet their statutory filing obligations to over 300,000 sole traders, partnerships and limited companies, covering a full range of businesses, particularly small and medium-sized enterprises and owner-managed entities.

² Paragraph 3 of the "Introduction" (condoc)

³ Figures correct as at 30 Sept 2014



If you have any questions or would like to consult further on this issue then please contact the AAT at:

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