

1 THE STRUCTURE OF UK GAAP

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INTRODUCTION

Financial reporting in the UK and Republic of Ireland has undergone considerable change over the last few years. This is because the standard-setters in the UK and Republic of Ireland (the Financial Reporting Council (FRC)) had always foreseen entities reporting under an international-based financial reporting framework. Since 2005, listed companies in the UK and Republic of Ireland have had to report under EU-adopted IFRS and during the transition to IFRS there were considerable problems encountered meaning lessons had to be learned. Since 2005, the FRC (previously the Accounting Standards Board) have been actively producing a framework for private companies to report under, which is based on IFRS. The intention by the (now defunct) Accounting Standards Board was to adopt an IFRS-based framework because IFRS has gathered pace much faster over the years. In addition, having a framework which is based on IFRS is said to improve comparability and consistency and open up capital markets.

FRS 102 THE FINANCIAL REPORTING STANDARD APPLICABLE IN THE UK AND REPUBLIC OF IRELAND

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* was issued on 14 March 2013. This marked the end of several years' work by the FRC (and the previous Accounting Standards Board) in developing a standard which was based on IFRS and which could be used by private companies. The standard itself was initially 350 pages long, which was a considerable reduction in volume from previous UK GAAP, which was some 3,500+ pages long. Professional accountants had often complained about the sheer volume of UK GAAP and the voluminous disclosures which it mandates. The Accounting Standards Board at the time also acknowledged that UK GAAP had become too voluminous and disjointed and hence it was more cost-effective to develop a new UK GAAP rather than change the previous GAAP.

FRS 102 is itself based on *IFRS for SMEs*, although it is not identical to *IFRS for SMEs* because *IFRS for SMEs* was not compatible with UK and Republic of Ireland companies legislation. In addition, *IFRS for SMEs* is based on the concept of 'public

accountability’, a concept which proved very difficult to define in the eyes of UK legislation. The initial Exposure Drafts of FRS 102 were based on the concept of public accountability, but this would have meant that certain entities would have had to adopt EU-adopted IFRS (for example, the smallest of pension schemes), which would not have been appropriate because of the associated disclosure requirements which IFRS requires.

FRS 102 was originally issued in March 2013 and was mandatory for accounting periods commencing on or after 1 January 2015 for those companies who were not reporting under the small companies’ regime (i.e. the Financial Reporting Standard for Smaller Entities (the FRSSE)). Early adoption was permissible, although the take-up for early adoption was not vast. Initially, medium-sized businesses were the main entities to adopt FRS 102 for their accounting periods beginning on or after 1 January 2015 and the original plan was to ensure that the medium-sized businesses transitioned across to the new regime and then the FRC would see how smoothly those transitions had gone. Small companies would continue to report under the FRSSE and originally the FRC said that they would eventually have to align the FRSSE with FRS 102 to ensure that no significant disparities in accounting and disclosures existed between the two standards.

THE EU ACCOUNTING DIRECTIVE

On 26 June 2013, the EU issued Directive 2013/34/EU of the European Parliament and of the Council (referred to as the EU Accounting Directive (the Directive)). It replaced the 4th and 7th Accounting Directives and established minimum legal requirements for financial statements in the EU as well as providing 100 Member State options. The overarching objective of the Directive is to allow more companies to have access to a less burdensome financial reporting regime than was the case under the previous Companies Act 2006. There are three core objectives to the Directive, which are to:

- simplify accounting requirements so as to reduce the administrative burden on companies with particular emphasis focused on smaller companies;
- increase the clarity and comparability of financial statements of companies so as to reduce the cost of capital and increase the level of cross-border trade and merger and acquisition activity; and
- protect essential user needs by retaining necessary accounting information for users.

The Directive’s objectives are therefore to simplify the accounting requirements for small entities within its scope and hence reduce the levels of disclosures contained in the financial statements. The Directive achieves this objective by applying a ‘think small first’ approach and this approach:

- introduces a ‘building block’ approach to the statutory accounts whereby disclosure levels are increased depending on the size of the undertaking;
- reduces the number of options available to preparers in respect of recognition, measurement and presentation; and

- creates a largely harmonised small companies' regime and, for the first time, limits the amount of information which Member States are permitted to require small undertakings to place in their annual financial statements.

The Directive states that small, medium-sized and large undertakings should be defined and distinguished by reference to balance sheet total, net turnover and the average number of employees during the financial year because this criterion usually provides objective evidence as to the size of the undertaking. The Directive also allows Member States the option of using maximum mandatory thresholds to determine company sizes or minimum mandatory thresholds. The Department for Business Innovation and Skills (BIS) confirmed that in order to allow more companies access to a less burdensome financial reporting regime, it would apply the maximum mandatory thresholds in the Directive (Chapter 2 examines the new thresholds).

In January 2015, BIS issued their response to the consultation in which it confirmed its decision to take advantage of the maximum thresholds which the Directive permits. This would, according to BIS, allow 11,000 medium-sized companies to be re-categorised and enable them to take advantage of the small companies' regime, thus allowing them to make less disclosure in their financial statements than would otherwise be the case. In their response to the consultation, BIS also confirmed that they would also apply the mandatory increases in the thresholds for medium-sized and large businesses. The transposition of the Directive into company law completed on 26 March 2015 and became effective from 6 April 2015 for accounting periods commencing on or after 1 January 2016, or for accounting periods commencing on or after 1 January 2015, but before 1 January 2016 if the directors wished. This early adoption clause was built into the legislation to allow a medium-sized business to consider whether it would fall to be classed as small under the revised Companies Act 2006 and hence possibly take advantage of the new small companies' regime.

RESPONSE BY THE FINANCIAL REPORTING COUNCIL

In light of the revisions to the Companies Act 2006, the FRC issued three Exposure Drafts on 19 February 2015 as follows:

- FRED 58 Draft FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*;
- FRED 59 *Draft Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Small entities and other minor amendments*; and
- FRED 60 *Draft Amendments to FRS 100 Application of Financial Reporting Requirements and FRS 101 Reduced Disclosure Framework*.

Unlike when the FRC have previously issued Exposure Drafts, on issuance of the above three Exposure Drafts, the FRC also included an 'Overview Document', which gave a brief outline as to the FRC's overall intentions. In addition to overhauling the financial reporting regime for smaller and micro-entities, the FREDs also incorporated other minor amendments to the FRSs.

The FRC took the decision to issue three FREDs in order to make a distinction between the different standards which have been affected by the proposals.

The Exposure Drafts were open for comment until April 2015. Once the comment period closed, the FRC took on board feedback which they received on the Exposure Drafts from various commentators and then made further changes to arrive at a set of finalised standards for small and micro-entities. The most notable changes to the Exposure Drafts in arriving at finalised standards were as follows:

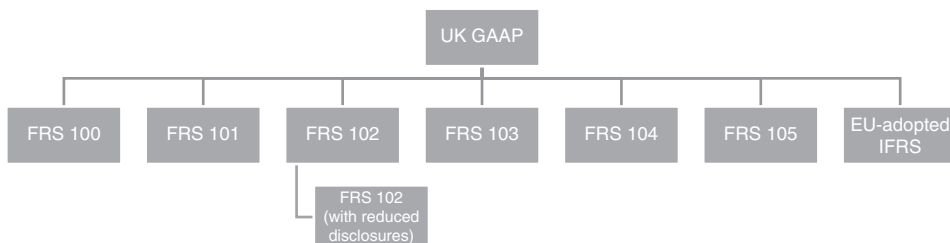
- A complete restructuring of Section 1A of FRS 102 *Small Entities*. The end result is a much more user-friendly and concise section and has the specific disclosure requirements split into two Appendices: Appendix C outlines those disclosures which are legally required and Appendix D outlines those disclosures which are encouraged in order that the financial statements of a small entity give a true and fair view.
- Restructuring of FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* to remove sections and paragraph numbers which are not applicable to micro-entities. The consequence of this is that the structure of FRS 105 is not the same as FRS 102.
- A switch from the performance method as a mandatory accounting treatment for micro-entities which receive government grants back to the accruals method.

The final standards were published by the FRC in summer 2015.

THE STRUCTURE OF NEW UK GAAP

The issuance of the new standards for small and micro-entities marked the end of several years of work undertaken by the FRC (and the previous Accounting Standards Board) in developing an IFRS-based framework for reporting entities in the UK and Republic of Ireland.

The following diagram illustrates the structure of new UK GAAP:



Each FRS in the above diagram is referred to as follows:

FRS 100 *Application of Financial Reporting Requirements* (September 2015)

FRS 101 *Reduced Disclosure Framework* (September 2015)

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* (September 2015)

FRS 103 *Insurance Contracts* (March 2014)

FRS 104 *Interim Financial Reporting* (March 2015)

FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* (July 2015)

The smallest companies in the UK can report under FRS 105 as this applies to micro-entities (see the later section ‘FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*’). Small companies (or micro-entities who choose not to apply FRS 105) can report under FRS 102 with reduced disclosures. Companies which are excluded from the small companies’ regime will report under full FRS 102. Companies that deal with insurance contracts (or reinsurance contracts) will apply the provisions in FRS 103. Listed companies, including those companies listed on the Alternative Investment Market (AIM), will report under EU-adopted IFRS.

The idea behind the frameworks is that they become more complex and require more disclosures the further up the suite of standards a company goes. For example, a small company will clearly make fewer disclosures in their financial statements than a company listed on the London Stock Exchange reporting under EU-endorsed IFRS.

FRS 100 *Application of Financial Reporting Requirements*

The latest version of FRS 100 *Application of Financial Reporting Requirements* is the September 2015 version. The overall objective of FRS 100 is to outline which types of entity will report under which financial reporting framework. The FRS itself applies to all financial statements which are intended to give a true and fair view in respect of the entity’s assets, liabilities, financial position and profit or loss for the accounting period.

It is to be noted that FRS 100 requires a ‘Statement of compliance’ for entities which apply the provisions of FRS 101 *Reduced Disclosure Framework* and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. Such a statement is included in the notes to the financial statements, unless the entity is a small entity reporting under FRS 102 with reduced disclosures in which case it is encouraged to make such a statement of compliance in the notes to the financial statements.

Statement of Recommended Practice

If an entity is required to apply a *Statement of Recommended Practice* (SORP), FRS 100 requires the relevant SORP to be applied in the circumstances which are set out in the relevant FRS. In addition, FRS 100 also requires an entity (other than a small entity) to state the title of the SORP which it is applying in the preparation of the financial statements and whether the financial statements have been prepared in accordance with the provisions of the SORP. If the entity has chosen to depart from the requirements of any relevant SORP, then FRS 100 requires the entity to

disclose a brief description of how the financial statements depart from the recommended practice outlined in the SORP. This should also include:

- (a) in respect of any accounting treatment which is not compliant with the requirements of the SORP, the reasons why the accounting treatment applied is judged to be appropriate; and
- (b) brief details relating to any disclosures which are recommended by the SORP, but which have not been provided together with the reasons why they have not been provided.

The overall objective of a SORP is to clarify how the requirements of an accounting framework (such as FRS 102) apply in the industry or sector which the reporting entity operates in. For example, a Limited Liability Partnership (LLP) that falls to be classed as small under the LLP Regulations will apply the requirements of FRS 102 with reduced disclosures. The SORP applicable to LLPs is the *Statement of Recommended Practice – Accounting by Limited Liability Partnerships*, which is issued by the Consultative Committee of Accountancy Bodies. A revised version is expected to be published in the summer of 2016.

The idea behind a SORP is that when an entity complies with the requirements of a relevant SORP, it enhances comparability of the financial statements among entities within the same industry or sector. Comparability is one of the key traits which financial statements must possess in order that interested stakeholders (for example, potential investors) can make reasoned and balanced decisions concerning the financial performance, financial position and cash flows of the reporting entity.

Where an entity departs from a requirement of the SORP, FRS 100 acknowledges that the effect of the departure need not be quantified, with the exception in rare situations where such quantification would be judged necessary in order that the reporting entity's financial statements give a true and fair view.

Some entities are not caught by the requirements of a SORP, but may choose to adopt the provisions of a relevant SORP in preparing their financial statements. Where this is the case, then the reporting entity is encouraged (under FRS 100) to disclose such facts.

Effective Date of FRS 100

The provisions in FRS 100 apply for accounting periods beginning on or after 1 January 2016. However, early adoption of FRS 100 is permitted; although if an entity early-adopts FRS 100 then it must also apply the edition of FRS 101, FRS 102 and FRS 105, which are effective for accounting periods commencing on or after 1 January 2016, and the entity will also be subject to the early application provisions which are set out in those FRSs. Where an entity chooses not to early-adopt then it must also not adopt the associated amendments made to FRS 101, FRS 102 and FRS 105 to accounting periods commencing prior to 1 January 2016.

Where FRS 100 is early-adopted then disclosure of that fact must be made in the financial statements. The exception to making this disclosure is where the entity is a micro-entity or a small entity. A small entity would be encouraged to make such disclosure.

First-time adoption of FRS 100

When a reporting entity adopts the provisions in FRS 100 for the first time, it must apply the transitional arrangements which are relevant to its specific circumstances, which are outlined as follows:

<i>Circumstances</i>	<i>What it must apply</i>
The entity is transitioning to EU-adopted IFRS	The transitional arrangements, which are set out in IFRS 1 <i>First-time Adoption of International Financial Reporting Standards</i> as adopted by the EU.
Qualifying entity transitioning to FRS 101	The provisions in paragraphs 6 to 33 of IFRS 1 as adopted by the EU (unless it is applying EU-adopted IFRS before the date of transition) together with the relevant appendices with the exception of paragraphs 6 and 21, which require an opening statement of financial position (balance sheet) to be presented as at the date of transition.
The entity is transitioning to FRS 102	The transitional provisions outlined in FRS 102.
The entity is transitioning to FRS 105	The transitional provisions outlined in FRS 105.

When a qualifying entity prepares their financial statements under EU-adopted IFRS prior to the date of transition to FRS 101 it will be preparing Companies Act individual accounts as per section 395(1)(a) of the Companies Act 2006 and will not be preparing International Accounting Standards (IAS) individual accounts. The reporting entity must consider whether any amendments are needed in order to comply with paragraph 5(b) of FRS 101 but it must not reapply the provisions in IFRS 1. Paragraph 5 of FRS 101 allows a qualifying entity to take advantage of the disclosure exemptions contained in paragraphs 7A to 9 of FRS 101 (subject to paragraph 7), but paragraph 5(b) requires the qualifying entity to make amendments to EU-adopted IFRS requirements, where considered necessary, so that the financial statements comply with the Companies Act 2006 and Regulations. The reason that paragraph 5(b) requires such amendments is so that the financial statements are compliant with UK legislative requirements.

Where the qualifying entity determines that amendments are necessary for the financial statements to be compliant with the Companies Act 2006 and Regulations, management must first determine whether the amendments have a material effect on the first set of financial statements presented.

Amendments have no material effect on the first financial statements

Where the amendments have no material effect on the first financial statements prepared under the new regime, the entity should make disclosure that it has undergone a transition to FRS 101 and give brief details of the disclosure exemptions which the entity has adopted for all periods presented in the financial statements.

Amendments are material on the first financial statements

Where the amendments do have a material effect, the qualifying entity's first financial statements must include the following:

- (a) narrative describing the nature of each change of the qualifying entity's accounting policies;
- (b) reconciliations of equity, which were determined under EU-adopted IFRS to its equity that has been determined in accordance with FRS 101 provisions. These reconciliations must be at both the date of transition to FRS 101 and also at the end of the latest period presented in the entity's most recent annual financial statements that have been prepared in accordance with EU-adopted IFRS; and
- (c) a reconciliation of the profit or loss which was determined under EU-adopted IFRS to the profit or loss determined under the provisions of FRS 101 for the latest period presented in the entity's most recent annual financial statements, which have been prepared to EU-adopted IFRS.

Paragraph 12(b) of FRS 101 allows for early adoption and where it is impracticable to apply the above amendments retrospectively, FRS 100 requires the qualifying entity to apply the amendments to the earliest period for which it is practicable to do so. In addition, the qualifying entity must also identify the data presented for prior periods which are not comparable with the data for the period in which the entity prepares its first financial statements that comply with the reduced disclosure framework set out in FRS 101.

FRS 101 Reduced Disclosure Framework

FRS 101 allows a *qualifying entity* to apply the provisions in FRS 101 *Reduced Disclosure Framework* and to take advantage of certain disclosure exemptions in the individual financial statements of subsidiaries, which also include intermediate parents, and ultimate parents which apply the recognition, measurement and disclosure requirements of EU-adopted IFRS.

The term 'qualifying entity' is pivotal in the application of FRS 101 and is defined in the Glossary to FRS 101. Essentially a qualifying entity is one where the parent company prepares consolidated financial statements (group accounts) which are intended to give a true and fair view and that group member is included in the consolidated financial statements. It is important to emphasise that charities cannot be qualifying entities.

The scope of FRS 101 also does not extend to those entities which are required to prepare consolidated financial statements and are not entitled to any of the exemptions in the following sections of the Companies Act 2006:

- Section 400 *Exemption for company included in EEA group accounts of a larger group*
- Section 401 *Exemption for company included in non-EEA group accounts of a larger group*

- Section 402 *Exemption if no subsidiary undertakings need to be included in the consolidation.*

Qualifying entities which also voluntarily choose to prepare consolidated financial statements cannot apply the provisions in FRS 101 and hence given the restrictions on the scope of FRS 101 it is important that care is taken in ensuring correct application of the FRS.

Protocol to be followed in taking disclosure exemptions under FRS 101

When a qualifying entity satisfies the criteria to use FRS 101 and wishes to take the disclosure exemptions in paragraphs 7A to 9 of FRS 101, it must ensure the following conditions are complied with:

- (a) The shareholders have been notified in writing informing them that the entity is proposing to apply the disclosure exemptions in FRS 101 and they do not object. Where a shareholder objects to the disclosure exemptions being applied, they must object within a reasonable specified timeframe and in an acceptable format. The shareholder must also be a shareholder of the immediate parent, or a shareholder(s) who hold(s) in total 5% or more of the total issued shares in the entity, or more than 50% of the issued shares in the entity, which are not held by the immediate parent.
- (b) The entity applies the recognition, measurement and disclosure requirements in EU-adopted IFRS but amendments are made to the requirements of EU-adopted IFRS where necessary so as to comply with the Companies Act 2006 and the Regulations. A qualifying entity is required to comply with the requirements of the Companies Act 2006 and the Regulations in preparing their financial statements and the Application Guidance in FRS 101 outlines the amendments necessary to remove conflicts between the requirements of EU-adopted IFRS and the Companies Act 2006 and the Regulations. FRS 101 also acknowledges that the Application Guidance in FRS 101 is an integral part of the standard.
- (c) The notes to the qualifying entity's financial statements provide the following disclosures:
 - (i) a brief summary of the disclosure exemptions that have been adopted; and
 - (ii) the name of the parent of the group in whose consolidated financial statements the qualifying entity's financial statements are included and where those consolidated financial statements can be obtained.

Financial institutions

Where a qualifying entity is a financial institution, it may take advantage in its individual financial statements of the disclosure exemptions in paragraphs 8 and 9 of FRS 101, with the exception of:

- (a) the disclosure exemptions in IFRS 7 *Financial Instruments: Disclosures*;

- (b) the disclosure exemptions in IFRS 13 *Fair Value Measurement* to the extent that they apply to financial instruments; and
- (c) the disclosure exemptions from paragraphs 134 to 136 of IAS 1 *Presentation of Financial Statements*.

First-time adoption of FRS 101

When a qualifying entity applies the provisions in FRS 101 for the first time, it is required to apply the requirements of paragraphs 6 to 33 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. A first-time qualifying entity does not, however, have to comply with the requirements of paragraphs 6 and 21, which require an opening statement of financial position (balance sheet) to be presented at the date of transition to FRS 101.

The disclosure exemptions in FRS 101

The table below outlines the disclosure exemptions which are available to qualifying entities under FRS 101.

<i>Relevant IFRS</i>	<i>Disclosure exemption available</i>
IFRS 2 <i>Share-based Payment</i>	<p>Requirements of paragraphs 45(b) and 46 to 52, provided that:</p> <ul style="list-style-type: none"> • if the qualifying entity is a subsidiary, the share-based payment arrangement concerns equity instruments of another group entity; or • if the qualifying entity is an ultimate parent, the share-based payment arrangement is in relation to its own equity instruments and the ultimate parent's own financial statements are presented alongside the consolidated accounts. <p>In both of the above cases, the equivalent disclosures must be made in the consolidated financial statements of the group in which the entity is consolidated.</p>
IFRS 3 <i>Business Combinations</i>	<p>The requirements in paragraphs 62, B64(d), B64(e), B64(g), B64(h), B64(j) to B64(m), B64(n)(ii), B64(o)(ii), B64(p), B64(q)(ii), B66 and B67. Again, equivalent disclosures must be included in the consolidated financial statements of the group in which the entity is consolidated.</p>
IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i>	<p>The requirements of paragraph 33(c) and equivalent disclosures must be made in the consolidated financial statements of the group in which the entity is consolidated.</p>
IFRS 7 <i>Financial Instruments: Disclosures</i>	<p>Exemption is available to qualifying entities in respect of all disclosure requirements, provided that the equivalent disclosures are made in the consolidated financial statements of the group in which the entity is consolidated.</p> <p>Note – a qualifying entity which is a financial institution cannot take advantage of this disclosure exemption.</p>

IFRS 13 <i>Fair Value Measurement</i>	The requirements of paragraphs 91 to 99 provided that equivalent disclosures are made in the consolidated financial statements of the group in which the entity is consolidated.
IAS 1 <i>Presentation of Financial Statements</i>	<p>Paragraph 38, which requires comparative information in relation to:</p> <ul style="list-style-type: none"> • paragraph 79(a)(iv) of IAS 1 • paragraph 73(e) of IAS 16 <i>Property, Plant and Equipment</i> • paragraph 118(e) of IAS 38 <i>Intangible Assets</i> • paragraph 76 and 79(d) of IAS 40 <i>Investment Property</i> • paragraph 50 of IAS 41 <i>Agriculture</i> <p>In addition, a qualifying entity can take advantage of the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136. Although for accounting periods starting before 1 January 2013, paragraphs 38A, 38B, 38C, 38D, 40A, 40B, 40C and 40D of IAS 1 (effective 1 January 2013) should be replaced with paragraphs 39 and 40 of IAS 1 (effective 1 January 2009).</p>
IAS 7 <i>Statement of Cash Flows</i>	A qualifying entity can take advantage of the exemption from preparing a statement of cash flows (cash flow statement) in its individual financial statements.
IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	The requirements of paragraphs 30 and 31.
IAS 24 <i>Related Party Disclosures</i>	The requirements of paragraphs 17 and 18A. In addition, a qualifying entity does not have to disclose transactions entered into between two, or more, group members provided that any subsidiary which is a party to the transaction is wholly owned by such a member.
IAS 36 <i>Impairment of Assets</i>	The requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) provided that equivalent disclosures are made in the consolidated financial statements of the group in which the entity is consolidated.

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland (September 2015)*

The ‘backbone’ of ‘new UK GAAP’ is in the form of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. This standard applies to all entities, with the exception of:

- micro-entities reporting under FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*; and
- entities reporting under EU-adopted IFRS.

At the time of writing, the latest version of FRS 102 is the September 2015 version. This version of FRS 102 incorporates provisions for small companies in the form of

Section 1A *Small Entities*, which was not found in previous editions of FRS 102. In addition, the FRC took the opportunity to make other minor amendments to the standard at the same time as incorporating presentation and disclosure requirements for small entities.

The vast majority of companies in the UK and Republic of Ireland will report under the provisions in FRS 102 and it offers a more compact financial reporting framework than previous UK GAAP did and is more aligned to the requirements of EU-adopted IFRS, which was always the intention by the FRC (and, of course, the previous Accounting Standards Board who initiated the ‘new UK GAAP’ project).

Structure of FRS 102

FRS 102 is structured in sections and each section of FRS 102 follows a structure. Each section starts with the Scope section, which outlines which entities or types of transactions do, and do not, fall under a particular section’s scope. It then moves into the detailed requirements of the section, which sometimes do vary depending on the section – for example, Section 33 *Related Parties* does not contain any recognition and measurement principles because the section is a wholly-disclosure standard. The disclosure requirements relevant to each section are always contained at the end of each section.

Example – Accounting policy change

Morley Ltd is reporting under the provisions of FRS 102 for its financial statements for the year ended 31 December 2017. During the year the directors decided to change the way in which it accounts for its borrowing costs as it is in the process of self-constructing a number of fixed assets. Prior to the change in accounting policy, the company always expensed borrowing costs immediately in profit or loss. However, the directors now feel that given the levels of borrowing costs they are currently incurring on such projects, the financial statements would be more relevant and reliable if such costs were capitalised.

Such a change in accounting methodology would constitute a change in accounting policy under the provisions of Section 10 *Accounting Policies, Estimates and Errors*. The directors have concluded that the effect of this accounting policy change is material and wish to make the required disclosures in respect of a voluntary change in accounting policy.

Accounting policies are changed where an FRS requires such a change or management deems the accounting policy change will enable the financial statements to provide more relevant and reliable financial information. As the change in accounting policy is material, the entity should make the required disclosures. In order to do this, management will look at the end of Section 10, which outlines the disclosure requirements and in respect of accounting policies these are split into two parts: the first part deals with the disclosure requirements in respect of an accounting policy change mandated because of an amendment to an FRS or FRC Abstract; the second part deals with a voluntary change in accounting policy. Management will therefore make the disclosures required by the second part of the disclosure section contained in paragraph 10.14 of FRS 102.

The structure of FRS 102 is as follows:

<i>Section</i>	<i>Content</i>
1	Scope
1A	Small Entities
	Appendix A: Guidance on adapting the balance sheet formats
	Appendix B: Guidance on adapting the profit and loss account formats
	Appendix C: Disclosure requirements for small entities
	Appendix D: Additional disclosures encouraged for small entities
2	Concepts and Pervasive Principles
3	Financial Statement Presentation
4	Statement of Financial Position
5	Statement of Comprehensive Income and Income Statement
	Appendix: Example showing presentation of discontinued operations
6	Statement of Changes in Equity and Statement of Income and Retained Earnings
7	Statement of Cash Flows
8	Notes to the Financial Statements
9	Consolidated and Separate Financial Statements
10	Accounting Policies, Estimates and Errors
11	Basic Financial Instruments
12	Other Financial Instruments Issues
	Appendix: Examples of hedge accounting
13	Inventories
14	Investments in Associates
15	Investments in Joint Ventures
16	Investment Property
17	Property, Plant and Equipment
18	Intangible Assets other than Goodwill
19	Business Combinations and Goodwill
20	Leases
21	Provisions and Contingencies
	Appendix: Examples of recognising and measuring provisions
22	Liabilities and Equity
	Appendix: Example of the issuer's accounting for convertible debt
23	Revenue
	Appendix: Examples of revenue recognition
24	Government Grants
25	Borrowing Costs
26	Share-based Payment
27	Impairment of Assets
28	Employee Benefits
29	Income Tax
30	Foreign Currency Translation
31	Hyperinflation

32	Events after the End of the Reporting Period
33	Related Party Disclosures
34	Specialised Activities: <ul style="list-style-type: none"> • Agriculture • Extractive Activities • Service Concession Arrangements • Financial Institutions • Retirement Benefit Plans: Financial Statements • Heritage Assets • Funding Commitments • Incoming Resources from Non-exchange Transactions • Public Benefit Entity Combinations • Public Benefit Entity Concessionary Loans • Appendix A: Guidance on funding commitments • Appendix B: Guidance on incoming resources from non-exchange transactions
35	Transition to this FRS <ul style="list-style-type: none"> Approval by the FRC <ul style="list-style-type: none"> The Accounting Council’s Advice to the FRC to issue FRS 102 The Accounting Council’s Advice to the FRC to issue Amendments to FRS 102 – Basic financial instruments and Hedge accounting The Accounting Council’s Advice to the FRC to issue Amendments to FRS 102 – Pension obligations The Accounting Council’s Advice to the FRC to issue Amendments to FRS 102 – Small entities and other minor amendments

The scope of FRS 102

FRS 102 is applied to financial statements which are intended to give a true and fair view (these are often referred to as ‘general purpose financial statements’). The scope of FRS 102 also extends to public benefit entities as well as to other forms of entity; in other words the scope of FRS 102 is not simply limited to incorporated entities (which is the case for FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*).

Each paragraph within the various sections of FRS 102 is prefixed with a number. Those paragraphs which are prefixed by ‘PBE’ must only be applied by *public benefit entities*. A ‘public benefit entity’ is an entity that provides goods or services for the general public, the wider community or for social benefit. Any ‘profit’ or ‘surplus’ generated by a public benefit entity is used to support the entity’s primary objectives as opposed to providing a return to equity holders, members or shareholders.

FRS 102 does not necessarily contain all the necessary legal requirements an entity is required to apply in the preparation of their financial statements and therefore the directors of reporting entities must be satisfied that they have discharged all their obligations required under company law. For small entities (and micro-entities that choose not to report under FRS 105), most legally required disclosures have been included in Section 1A *Small Entities* in Appendix C

Disclosure requirements for small entities but the section does not include the disclosure requirements which become relevant when the small entity is subject to external audit.

As stated earlier in this chapter, FRS 100 *Application of Financial Reporting Requirements* outlines which types of entity will use a particular financial reporting framework. The regime is not designed to be inflexible; indeed micro-entities have a choice of whether to apply FRS 105 or a more comprehensive financial reporting framework, such as FRS 102 Section 1A. However, certain entities are mandated to apply a certain framework. For example, FRS 100 says that an entity which is required by IAS Regulation to prepare consolidated financial statements in accordance with EU-adopted IFRS must do so – they have no choice where this is concerned. However, the *individual* financial statements of such an entity, or the individual financial statements or consolidated financial statements of any other type of entity that fall within the scope of FRS 100, are to be prepared in accordance with:

- FRS 105 if the entity is eligible to apply FRS 105 and chooses that framework to report under; or
- if the entity is not eligible to apply FRS 105, or is eligible but chooses not to apply FRS 105, then the financial statements are to be prepared in accordance with FRS 102 (with reduced disclosure if the entity wishes), full FRS 102 or EU-adopted IFRS.

Earnings per share

Where a reporting entity chooses to disclose earnings per share, or where the entity's ordinary shares or potential ordinary shares are traded on a recognised securities commission (for example, the London Stock Exchange) for the purposes of issuing ordinary shares in a public market, then the provisions in EU-adopted IAS 33 *Earnings per Share* must be applied in the financial statements.

Operating segments

A similar principle to the above paragraph relates to the provision of segment information. Entities whose shares are traded in a public market or an entity that chooses to provide segment information must apply the provisions in EU-adopted IFRS 8 *Operating Segments*. However, if the entity chooses to disclose disaggregated information but that information is not compliant with the requirements outlined in IFRS 8, then the entity should not describe that information as being segment information.

Insurance contracts

Where an entity issues insurance or reinsurance contracts or issues financial instruments which have a discretionary participation feature, then the entity is required to apply FRS 103 *Insurance Contracts* in the preparation of its financial statements.

Application of IAS 33 Earnings per Share, IFRS 8 Operating Segments and IFRS 6 Exploration for and Evaluation of Mineral Resources

Where the reporting entity chooses to apply any of the above IFRSs, then any references made to other IFRSs within IAS 33, IFRS 8 or IFRS 6 are taken to be the references which apply to the relevant section or paragraph of FRS 102.

FRS 103 Insurance Contracts

FRS 103 *Insurance Contracts* was issued by the FRC in March 2014. FRS 103, together with its accompanying non-mandatory Implementation Guidance, brings together existing financial reporting requirements as well as the guidance for insurance contracts. FRS 103 is based on the international equivalent, IFRS 4 *Insurance Contracts*, which was issued by the International Accounting Standards Board in 2013, except to the extent that it was amended by IFRS 13 *Fair Value Measurement*. FRS 103 is also based on the requirements in outgoing UK GAAP at FRS 27 *Life Assurance* prior to that standard being withdrawn and superseded by FRS 103 as well as some of the elements found in the Association of British Insurers' *Statement of Recommended Practice on Accounting for Insurance Business* published in December 2005 and amended in December 2006.

FRS 103 allows an entity under its scope to continue using existing accounting policies for their insurance contracts, including the appropriate measurement of long-term insurance business but also permits limited improvements to accounting by insurers. FRS 103 also requires entities falling under the standard's scope to make disclosures which:

- (a) identify and explain the amounts contained in an insurer's financial statements which have arisen from insurance contracts, including reinsurance contracts, which the entity issues and reinsurance contracts which it holds;
- (b) relate to the financial strength of entities which carry long-term insurance business; and
- (c) enable users of those financial statements to understand the amount, timing and uncertainty of future cash flows relative to those insurance contracts.

Whilst FRS 103 does allow entities within its scope to continue applying their existing accounting policies, the standard does allow entities to make improvements (within the constraints of legal and statutory requirements) as entities that apply EU-adopted IFRS 4 have. The idea behind this flexibility is so that FRS 103 is no more onerous than IFRS 4 in terms of its application. Notwithstanding this flexibility, the FRC have acknowledged that the standard does form part of a suite of new standards which will inevitably lead to change for insurers, such as the different ways of treating financial instruments. However, it should be borne in mind that the FRC expect FRS 103 to only have a limited lifespan and hence is the reason why insurers can continue with their existing accounting policies. At the time of writing, the International Accounting Standards Board (IASB) were in the process of developing an updated standard dealing with insurance contracts and hence it is expected that once the IASB completes its work on this new standard, the FRC will also follow suit and issue a revised standard for the UK and Republic of Ireland.

At the time of writing, the timing of the new IFRS on insurance contracts was currently unknown (although the IASB have intimated that they may publish the revised standard towards the end of 2016) and hence interim amendments may be made to FRS 103 in the future to deal with changes in the regulatory regime for insurers once these have been finalised.

Entities that issue insurance contracts which are not legally recognised as an insurer

Some entities may issue contracts which meet the definition of an insurance contract under FRS 103, but they may not be legally constituted as an insurance provider. A typical example of where this might arise is in relation to product warranty agreements. Where these contracts are issued, the entity would be able to continue with its current accounting policies to such contracts but the entity must consider any other factors which may be relevant under FRS 103, such as the liability adequacy test as well as additional disclosure requirements which might be necessary under FRS 103, which might not have been made under the previous accounting framework.

Requirements of FRS 103

Detailed discussions about FRS 103 are not dealt with in this particular chapter due to the specialist nature of the standard. However, Chapter 29 *Entities Dealing with Insurance Contracts* does examine the principles contained in FRS 103 in more detail.

FRS 104 Interim Financial Reporting

FRS 104 *Interim Financial Reporting* was issued by the FRC in March 2015. At the outset it is important to understand that despite its name, FRS 104 is *not* an accounting standard and hence there is no new requirement under the new UK GAAP for entities to produce interim financial statements.

When the FRC issued FRS 102, they took the decision not to include interim reporting requirements within the body of the standard but instead they chose to update the existing guidance contained in the ASB Statement *Half-yearly reports*.

FRS 104 is based upon the requirements of the international equivalent, IAS 34 *Interim Financial Reporting*. The standard itself does not require a reporting entity to prepare a set of interim financial statements, nor does it make any amendments to the laws or regulations which may require interim financial statements to be prepared by an entity. However, reporting entities are obliged to consider whether any such laws or regulations do require them to prepare interim financial statements (for example, paragraph 4.2.2R of the Disclosure and Transparency Rules requires listed entities to prepare a half-yearly financial report, which also includes a condensed set of financial statements). In addition, those entities listed on the Alternative Investment Market (AIM) are also required to prepare a half-yearly report under the AIM Rules for Companies, which are issued by the London Stock Exchange.

Some entities may also prepare interim financial statements as a matter of course and where this is the case FRS 104 does not require such reports to be prepared in accordance with its requirements. However, where the entity makes a statement of compliance with FRS 104, it must apply all of the provisions in FRS 104.

Detailed examination of FRS 104 is contained in Chapter 26 *Interim Financial Reporting*.

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

The micro-entities legislation was issued by the European Union (EU) in September 2013 and has applied ever since. In response to this legislation, the FRC incorporated the requirements of the micro-entities legislation into the Financial Reporting Standard for Smaller Entities (the FRSSSE) in both the April 2008 and January 2015 versions. This was never intended to be a long-term solution, but merely a temporary measure so as to make the micro-entities regime available to entities which qualify to use the framework.

On issuing the new suite of standards for small and micro-entities, the FRC decided to ‘carve out’ the micro-entities regime into its own FRS, being FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* issued in July 2015. This decision was taken on the basis of the significant levels of disclosure reductions brought about by the micro-entities legislation and the lack of accounting policy choices which are available and hence it was sensible to have a standalone standard for micro-entities.

At the time of writing, FRS 105 was not currently available to companies in the Republic of Ireland because there is no equivalent Irish legislation recognising micro-entities. However, the Irish Department of Jobs, Enterprise and Innovation have consulted on the possible enactment of the micro-entities legislation and therefore if the Republic of Ireland do enact such legislation, FRS 105 will be available to qualifying entities.

While FRS 105 is considered by the FRC to be the least complex standard, every entity which is eligible to apply the standard must consider its appropriateness because for some micro-entities, FRS 105 will be appropriate, but for others it may not be. It is important to emphasise that FRS is optional and a micro-entity could choose a more comprehensive framework to report under if it so wishes, such as FRS 102 with reduced disclosure.

Principles in FRS 105

FRS 105 is based on the recognition and measurement requirements in FRS 102, which is a sensible approach as all UK GAAP standards are then based on a consistent framework. However, in drafting FRS 105, the FRC have made additional simplifications due to the standard’s target audience, which are discussed in Chapter 28 *Financial Statements for Micro-Entities*.

KEY POINTS

Some of the key points to remember from this chapter are:

- UK GAAP is now based on IFRS, which was always the intention by the UK and Republic of Ireland standard-setters.
- Companies classed as small in the UK and Republic of Ireland must report under FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* with reduced disclosures for accounting periods commencing on or after 1 January 2016 (earlier adoption of FRS 102 with reduced disclosures is permissible).
- Micro-entities can report under FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*, which is currently unavailable for companies based in the Republic of Ireland.
- FRS 105 is optional and hence a micro-entity can adopt a more comprehensive framework if it so chooses.
- Listed companies report under EU-adopted IFRS for which FRS 102 and FRS 105 have no impact.
- The EU Accounting Directive simplifies the disclosure requirements for small and micro-entities.
- FRS 100 *Application of Financial Reporting Requirements* outlines which entities apply which financial reporting framework; FRS 101 *Reduced Disclosure Framework* offers reduced disclosures for qualifying group members; FRS 103 *Insurance Contracts* applies to companies that deal in insurance or reinsurance contracts; FRS 104 *Interim Financial Reporting* applies to those companies that prepare interim financial reports, but FRS 104 is not recognised as an accounting standard and so there is no new requirement for companies to start preparing interim financial reports if they do not already do so.
- The scope of FRS 102 also extends to public benefit entities as well as to other forms of entity; in other words the scope of FRS 102 is not simply limited to incorporated entities (which is the case for FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*).

