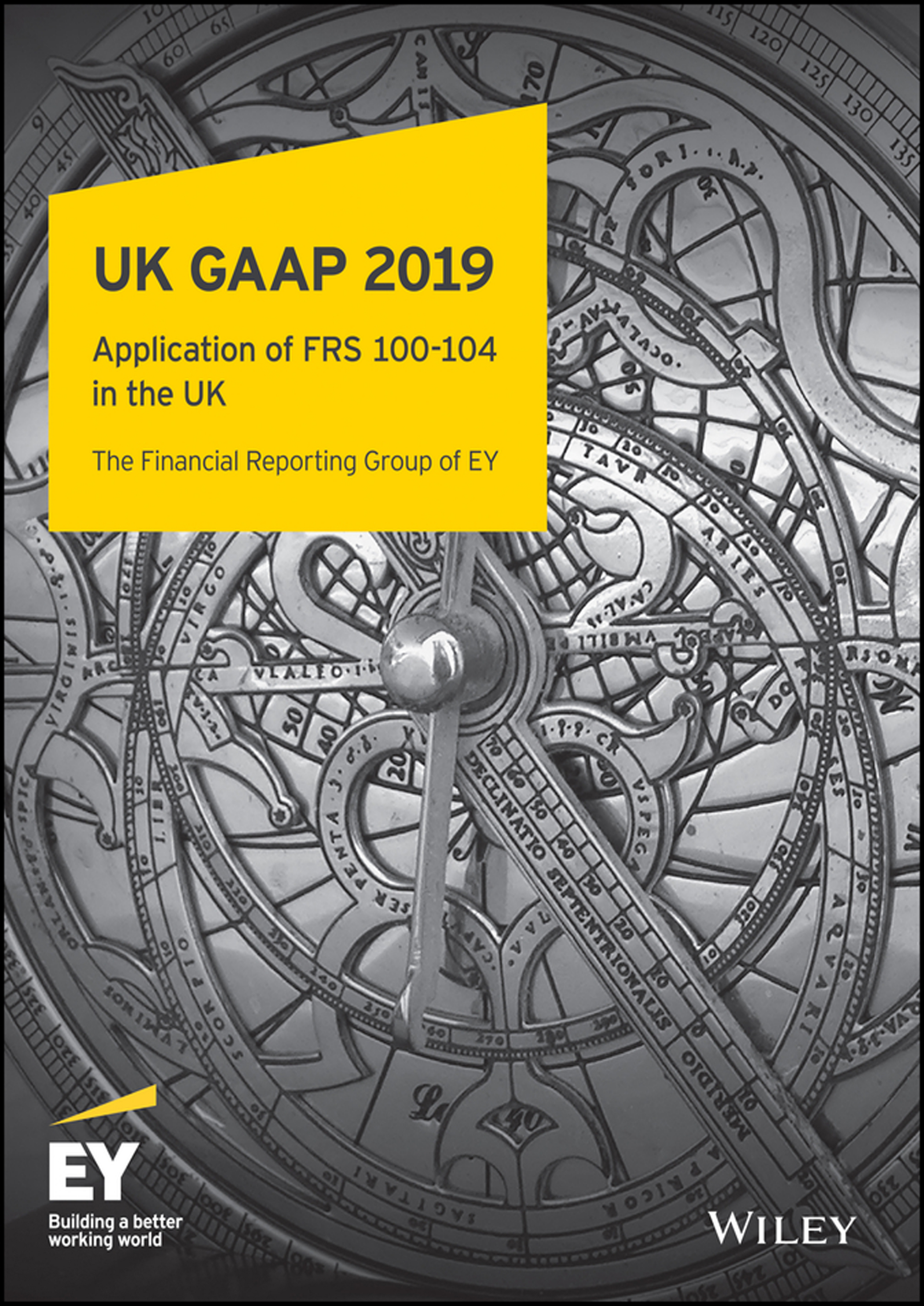

UK GAAP 2019

Application of FRS 100-104 in the UK

The Financial Reporting Group of EY

EY
Building a better working world

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About this book

UK GAAP 2019 is the third edition of the EY publication on UK GAAP following the replacement of all previous UK accounting standards with new financial reporting standards. The original publication, New UK GAAP 2015, was published in 2015 and a revised edition, UK GAAP 2017, was published in 2017. This publication has been fully revised and updated in order to:

- incorporate the amendments made to FRSs 100-104 in December 2016, May 2017, July 2017 and December 2017. This includes the *Amendments to FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland – Triennial review 2017 and Incremental improvements and clarifications* (published in December 2017). (Triennial review 2017) The changes made by the Triennial review 2017 are discussed in each relevant chapter;
- include the changes to legal requirements for UK companies and LLPs introduced since the previous edition; and
- provide further insight on the many issues relating to the practical application of the new UK accounting standards, based on the extensive experience of the book's authors in dealing with recent day-to-day issues. In particular, additional guidance on accounting for group reconstructions, including hive-up, hive-down and hive-across transactions, has been included in Chapter 17.

This book comprises 34 chapters. Each chapter includes a detailed list of contents and list of illustrative examples. The book contains an index of references to standards and interpretations.

FRS 101 – *Reduced Disclosure Framework – Disclosure exemptions from EU-adopted IFRS for qualifying entities* – uses the recognition and measurement principles of International Financial Reporting Standards (IFRS). In certain circumstances, FRS 102 also refers entities to IFRS. Detailed guidance on applying IFRS can be found in EY's publication, EY International GAAP 2019®.

Preface

With effect from accounting periods beginning on or after 1 January 2015 (or, for small entities that choose to apply the small entities regime and micro entities that choose to apply the micro entities regime, accounting periods beginning on or after 1 January 2016), all previous UK GAAP was replaced with new Financial Reporting Standards (FRSs 100-105) along with the associated accounting requirements of the Companies Act 2006 (CA 2006).

Since the publication of UK GAAP 2017, further amendments have been made to FRSs 100-104. The most significant of these were as a result of the first triennial review of the new standards. When FRS 102 was issued originally in March 2013, the FRC indicated that it would be reviewed every three years. The first triennial review was completed in December 2017 and revised versions of FRSs 100-104 were issued in March 2018 reflecting those amendments as well as incorporating amendments issued subsequent to the previous versions of the standards. The Triennial review 2017 amendments are mandatory for accounting periods beginning on or after 1 January 2019. These amendments can be adopted early provided that all are applied at the same time although there are two exceptions to this general rule.

The Triennial review 2017 amendments were developed in response to stakeholder feedback and therefore address a number of implementation issues reported to the FRC, many of which were highlighted in the previous edition of this publication. In our view, the principal changes to FRS 102 which are likely to have the most impact relate to:

- the introduction of an accounting policy choice for entities that rent investment property to other group entities, to reclassify those properties as property, plant and equipment and measure those properties either at cost (less depreciation or impairment) or at fair value;
- the introduction of more guidance supporting the conditions for classifying a financial instrument as 'basic', including a principles-based approach for classification of a debt instrument as a 'basic' financial instrument. Other changes to financial instrument accounting include an amendment to allow loans with two way compensation clauses (common in social housing loans) to be classified as 'basic' financial instruments and guidance on debt-for-equity swaps;
- for small entities, the ability to initially measure a loan from a person within a directors' group of close family members that includes at least one shareholder at transaction price rather than present value;
- a revised definition of separable intangible assets acquired in a business combination, which is likely to result in fewer intangible assets being separated from goodwill. However, entities may choose to separately recognise additional intangible assets if this provides useful information to the entity and to the users of its financial statements;

- an amended definition of a financial institution, which removes references to 'generate wealth' and 'manage risk' as well as eliminating stockbrokers and retirement benefit plans from the definition. This is intended to reduce interpretational difficulties and the number of entities meeting the definition of a financial institution; and
- an amendment to allow the tax effect of gift aid payments by subsidiaries to their charitable parents to be taken into account at the reporting date when it is probable that the gift aid payment will be made in the following nine months.

Following consultation, the FRC did not introduce elements of IFRS 9 – *Financial Instruments*, IFRS 15 – *Revenue from Contracts with Customers* – and IFRS 16 – *Leases* – into FRS 102 in the Triennial review 2017. The FRC's current intention is to consider major changes to IFRS on a case-by-case basis and to monitor any implementation issues arising before any consultation process begins.

Going forward, the FRC now envisages that FRS 102 will be subject to periodic review every four to five years rather than the three year cycle originally envisaged. The reason for the change in time frame is to allow time for experience of the most recent edition of FRS 102 to emerge before seeking stakeholder feedback. However, the FRC will continue to assess emerging issues as they arise and therefore it is possible that there will be amendments issued outside the regular review cycle.

Since the publication of EY UK GAAP 2017, the FRC has issued amendments to FRS 101 with the main purpose of providing disclosure exemptions from IFRS 16 and to reflect the EU endorsement of IFRS 9. The amended definition of a financial institution discussed above also applies to FRS 101.

On 29 March 2017, the UK Government started the legal process of negotiating a withdrawal by the UK from the European Union (EU). Under the provisions of the relevant laws and treaties, the UK will leave the EU by 29 March 2019, unless either a deal is reached which results in a change to the date of departure, or the negotiation period is extended by unanimous consent of the European Council. On 14 November 2018 a *Draft Agreement on the Withdrawal of the United Kingdom from the European Union* was published. At the time of writing this publication, the draft agreement is subject to approval of the UK parliament. This approval is uncertain. Other scenarios remain a possibility.

After the EU referendum result, the FRC issued a press notice confirming that companies must continue to abide by the regulations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect. Many requirements that derive from EU legislation, treaties and directives have been directly incorporated into UK company law. As a result, even in the event of EU legislation ceasing to apply, UK financial and reporting regulations will not change until applicable company law and regulations are amended. In particular, the application of EU adopted IFRS is enshrined in the CA 2006 and nothing will change in that respect without a change to the CA 2006.

The Accounts and Reports (Amendment) (EU Exit) Regulations 2018 were laid in draft before Parliament on 31 October 2018. This draft Statutory Instrument amends certain provisions of the CA 2006 that refer to the EU, EEA or entities within these areas. The timing of the effective date of this proposed legislation depends on whether or not a transition period is agreed with the EU.

The UK will also need to establish its policy on the endorsement of future IFRSs. It appears likely, at the time of writing this publication, that a UK endorsement process will be established although any details are yet to be published.

Given the uncertain nature of the final terms of the UK's withdrawal from the EU, the final form of the draft legislation described above and the extent of further legislative and regulatory changes in the UK affecting the financial reporting framework, the matters referred to above are subject to change.

FRS 102 is much shorter in length than either IFRS or previous UK GAAP and, as a result, is less prescriptive on many issues. This publication includes our views on the judgemental areas we believe are likely to be most common in practice based on our experience of applying the new standards and similar issues encountered in applying IFRS. As experience of applying FRS 102 grows over time, we expect our views will continue to evolve. It is not possible for this publication to cover every aspect of company reporting. For some of the more complicated or less common areas which are not covered by FRS 102 and for which IFRSs provide relevant guidance, further explanations can be found in our publication International GAAP® 2019.

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We are deeply indebted to many of our colleagues within the UK organisation of EY for their selfless assistance and support in the publication of this book.

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	Jane Hurworth	*Tina Patel*	

List of chapters

References and abbreviations

The following references and abbreviations are used in this book:

References in index of standards:

Foreword.19	Paragraph 19 of the Foreword to Accounting Standards issued by the FRC (March 2018)
FRS 100 Summary (i)	Paragraph i of the Summary of FRS 100
FRS 100.4	Paragraph 4 of FRS 100
FRS 100 Appendix I	Appendix I:Glossary to FRS 100
FRS 100.AG7	Paragraph 7 of the Application Guidance to FRS 100
FRS 101.10	Paragraph 10 of FRS 101
FRS 101 Appendix I Table 1	Table 1 of Appendix I to FRS 101
FRS 101 Appendix III.2	Paragraph 2 of Appendix III to FRS 101
FRS 101.BC15	Paragraph 15 of the Basis for Conclusions to FRS 101
FRS 102.1A.7	Paragraph 7 of Section 1A of FRS 102
FRS 102.23.9	Paragraph 9 of Section 23 of FRS 102
FRS 102.PBE34.89	Paragraph PBE34.89 of Section 34 of FRS 102
FRS 102 Appendix I	Appendix I of FRS 102: Glossary
FRS 102 Appendix II	Appendix II of FRS 102: Table of equivalence for company law terminology
FRS 102 Appendix III.5	Paragraph 5 of Appendix III of FRS 102: Note on legal requirements
FRS 102 Appendix IV.1	Paragraph 1 of Appendix IV to FRS 102: Republic of Ireland legal references
FRS 102.BC.B2.7	Paragraph B2.7 of the Basis for Conclusions to FRS 102
FRS 103.1	Paragraph 1 of FRS 103
FRS 103.IG2.15	Paragraph 15 of Section 2 of the Implementation Guidance to accompany FRS 103
FRS 103 Appendix II.5	Paragraph 5 of Appendix II to FRS 103: Definition of an insurance contract
FRS 103.BC18	Paragraph 18 of the Basis for Conclusions to FRS 103

FRS 104.1	Paragraph 1 of FRS 104
FRS 105.1	Paragraph 1 of FRS 105
FRS 11.9	Paragraph 9 of FRS 11
SSAP 19.11	Paragraph 11 of SSAP 19
FRSSE 6.51	Paragraph 6.51 of the Financial Reporting Standard for Smaller Entities
IFRS 1 Appendix A	Appendix A of IFRS 1
IFRS 3.29	Paragraph 29 of IFRS 3
IFRS 4.IG70	Paragraph 70 of the Implementation Guidance to IFRS 4
IFRS 10 Appendix B.98	Paragraph 98 of Appendix B to IFRS 10
IAS 1.12	Paragraph 12 of IAS 1
IAS 27.15 (2012)	Paragraph 15 of the version of IAS 27 effective in 2012
IFRIC 18.BC22	Paragraph 22 of the Basis for Conclusions to IFRIC 18
s395(2)	Section 395 subsection (2) of the Companies Act 2006
s408 (LLP)	Section 408 of The Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (SI 2008/1911)
Regulations 6(2)	Paragraph 6(2) of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/1910)
1 Sch 55	Paragraph 55 of Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/1910)
Regulations (SC) 8	Paragraph 8 of the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409)
1 Sch 1C (SC)	Paragraph 1C of Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409)
LLP Regulations 3	Paragraph 3 of The Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913)
1 Sch 1 (LLP)	Paragraph 1 of Schedule 1 to The Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913)
LLP SC Regulations 6	Paragraph 6 of The Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912)

1 Sch 10(2) (LLP SC)	Paragraph 10(2) of Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912)
TECH 02/17BL	Technical Release 02/17BL: *Guidance on Realised and Distributable Profits under the Companies Act 2006* issued by the ICAEW and ICAS (April 2017)
DTR 7.2	Paragraph 7.2 of the Disclosure and Transparency Rules
LR 11	Paragraph 11 to the LSE Listing Rules
LLP SORP Appendix 4	Appendix 4 to the Statement on Recommended Practice – Accounting by Limited Liability Partnerships - issued by the CCAB (January 2017)

Professional and regulatory bodies:

BEIS	Department for Business, Energy & Industrial Strategy
CCAB	Consultative Committee of Accountancy Bodies
CRC	Corporate Reporting Council (formally Accounting Council (AC))
FRC	Financial Reporting Council
IASB	International Accounting Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICAS	Institute of Chartered Accountants of Scotland
IFRIC	International Financial Reporting Interpretations Committee
PRA	Prudential Regulation Authority
TAG	UK GAAP Technical Advisory Group

Accounting related terms:

AIM	Alternative Investment Market
CA 2006	Companies Act 2006
CGU	Cash-generating unit
Code	The UK Corporate Governance Code (April 2016) issued by the FRC
E&E	Exploration and evaluation
EBIT	Earnings before interest and taxes
EBITDA	Earnings before interest, tax, depreciation and amortisation
EBT	Employee benefit trust
EIR	Effective interest rate
EPS	Earnings per share

FC	Foreign currency
FIFO	First-in, first-out basis of valuation
FRED	Financial Reporting Exposure Draft (issued by the FRC)
FRS	Financial Reporting Standard (issued by the FRC)
FRSSE	Financial Reporting Standard for Smaller Entities
FTA	First-time adoption
FVLCD	Fair value less costs of disposal
FVLCS	Fair value less costs to sell
GAAP	Generally Accepted Accounting Practice
IAS	International Accounting Standard (issued by the former board of the IASC)
IBOR	Interbank offer rate
IFRS	International Financial Reporting Standard (issued by the IASB)
IIR	Implicit interest rate (in a lease)
IRR	Internal rate of return
JA	Joint arrangement
JANE	Joint arrangement that is not an entity
JCA	Jointly controlled asset
JCE	Jointly controlled entity
JV	Joint venture
LIBOR	London Inter Bank Offered Rate
LIFO	Last-in, first-out basis of valuation
LLP	Limited liability partnership
LLP Regulations	The Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913)
NCI	Non-controlling interest
NBV	Net book value
NPV	Net present value
NRV	Net realisable value
OCI	Other comprehensive income
PP&E	Property, plant and equipment
R&D	Research and development
Regulations	The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)
SCA	Service concession arrangement
SE	Structured entity

SI 2015/980	The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 (SI 2015/980)
SI 2016/575	The Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016 (SI 2016/575)
Small Companies Regulations	The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409)
Small LLP Regulations	The Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912)
SME	Small or medium-sized entity
SORP	Statement of Recommended Practice
SPE	Special purpose entity
SSAP	Statement of Standard Accounting Practice
SV	Separate vehicle
TSR	Total shareholder return
Triennial review 2017	*Amendments to FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland - Triennial review 2017 and Incremental improvements and clarifications* – issued in December 2017
2016 FRC Guidance	Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks – Guidance for directors of companies that do not apply the UK Corporate Governance Code (April 2016) - issued by the FRC
UITF	Urgent Issues Task Force
UK	United Kingdom
VIU	Value in use
WACC	Weighted average cost of capital

Authoritative literature

The content of this book takes into account all UK accounting standards and exposure drafts extant as at November 2018.

References to the main text of each chapter to the pronouncements below for FRSs 100-105 are generally based on the version of the standard issued in March 2018 (which incorporate amendments made in December 2017 and earlier).

Accounting Standards

Foreword to Accounting Standards (March 2018)

FRS 100 – Application of Financial Reporting Requirements (March 2018)

FRS 101 – Reduced Disclosure Framework – Disclosure exemptions from EU-adopted IFRS for qualifying entities (March 2018)

Amendments to Basis for Conclusions FRS 101 – Reduced Disclosure Framework – 2017/2018 cycle (May 2018)

FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland (March 2018)

FRS 103 – Insurance Contracts – Consolidated accounting and reporting requirements for entities in the UK and Republic of Ireland issuing insurance contracts (March 2018)

FRS 104 – Interim Financial Reporting (March 2018)

FRS 105 – The Financial Reporting Standard applicable to the Micro-entities Regime (March 2018)

Chapter 1 FRS 100 – Application of financial reporting requirements

List of examples

Chapter 1 FRS 100 – Application of financial reporting requirements

1 INTRODUCTION

In 2012, 2013 and 2014 the Financial Reporting Council (FRC), following a lengthy period of consultation (between 2002 and 2012), changed financial reporting standards in the United Kingdom and the Republic of Ireland. Evidence from consultation supported a move towards an international-based framework for financial reporting that was proportionate to the needs of preparers and users.

As a result of the changes, 'UK and Irish GAAP' now consists of the following Financial Reporting Standards:

- FRS 100 – *Application of Financial Reporting Requirements*;
- FRS 101 – *Reduced Disclosure Framework: Disclosure exemptions from EU-adopted IFRS for qualifying entities* (see Chapter 2);
- FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland*;
- FRS 103 – *Insurance Contracts – Consolidated accounting and reporting requirements for entities in the UK and Republic of Ireland issuing insurance contracts* (see Chapter 33);
- FRS 104 – *Interim Financial Reporting* (see Chapter 34); and
- FRS 105 – *The Financial Reporting Standard applicable to the Micro-entities Regime*.

This chapter deals only with the application of FRS 100. This standard, which was issued originally in November 2012, sets out the new financial reporting framework and applies to entities preparing financial statements in accordance with legislation, regulations or accounting standards applicable in the UK and the Republic of Ireland (i.e. FRSs 101 to 105). *[FRS 100.1]*.

This chapter deals only with the March 2018 version of FRS 100, which incorporates the changes made by *Amendments to FRS 102 The Financial Reporting Standard* *applicable in the UK and Ireland – Triennial review 2017 – incremental improvements and clarifications* (Triennial review 2017).

Under the Companies Act 2006 (CA 2006) the choice of financial reporting framework is closely related to the requirements of company law or other regulatory requirements. UK companies with transferable securities admitted to trading on a regulated market (at the financial year end) are required under the IAS Regulation to prepare their consolidated financial statements using EU-adopted IFRS. A list of regulated markets is available online.[1]

Entities that are not required by UK company law to prepare financial statements using EU-adopted IFRS may be required to do so by other regulatory requirements, such as the AIM Rules (see 4.4.1 below) or by other agreements (e.g. shareholders' or partnership agreements).

However, other UK companies are permitted to prepare their consolidated and/or individual financial statements as IAS accounts (using EU-adopted IFRS) or Companies Act accounts (using 'applicable accounting standards' – see 4.6.1 below), subject to company law restrictions concerning the 'consistency of financial reporting framework' used in the individual accounts of group undertakings and over changes in financial reporting framework from IAS accounts to Companies Act accounts. See 6.1.2 below.

The requirements for preparation of financial statements under the CA 2006 are addressed at 6 below. Except where otherwise stated, the rest of this chapter will refer to the requirements for UK companies, and therefore will refer to UK GAAP prior to implementation of FRS 100 to FRS 103 and FRS 105 as 'previous UK GAAP'. UK LLPs and other entities preparing financial statements in accordance with Part 15 of the CA 2006 are subject to similar requirements, modified as necessary by the regulations that govern the content of their financial statements.

2 SUMMARY OF FRS 100

The following is a summary of FRS 100:

- FRS 100 sets out the application of the financial reporting framework for UK and Republic of Ireland entities (see 4 below). The detailed accounting requirements are included in EU-adopted IFRS, FRS 101, FRS 102 and FRS 105, depending on the choice of GAAP made by the entity. FRS 103 applies to financial statements prepared in accordance with FRS 102. FRS 104 applies to interim financial statements and can be applied by entities preparing annual financial statements under FRS 101 or FRS 102.
- FRS 100 sets out the effective date of the new standards. FRS 100, FRS 101, FRS 102 and FRS 103 were mandatory, effective for accounting periods beginning on or after 1 January 2015. However, the Triennial review 2017 amendments to FRS 100 to FRS 105 (which are included in the March 2018 editions of these standards) are mandatory, effective for accounting periods beginning on or after 1 January 2019. Early application of the March 2018 edition of FRS 100 is permitted providing that all the Triennial review 2017 amendments to the standard are applied at the same time. *[FRS 100.10A]*.

- FRS 100 sets out the application of SORPs (see 4.7 below).
- FRS 100 sets out the transition arrangements to FRS 101, FRS 102, and FRS 105 (see 5 below).
- FRS 100 withdrew virtually all previous UK GAAP, with effect from its original application date of 1 January 2015. Some parts of previous UK GAAP have been retained by incorporation of their requirements into FRS 101, FRS 102 or FRS 103 (see 4.3 below).
- FRS 100 includes application guidance on the interpretation of 'equivalence' for the purposes of:
  - (i) the exemption from preparation of consolidated financial statements in section 401 of the CA 2006. This is discussed in Chapter 2 at 2.3 (for FRS 101) and Chapter 8 at 3.1.1 (for FRS 102) but the same requirements apply to IAS accounts; and
  - (ii) the reduced disclosure framework discussed in Chapter 2 (for FRS 101) and in Chapter 3 at 3 (for FRS 102) respectively.

3 DEFINITIONS

The following terms used in FRS 100 are as defined in the Glossary (included as Appendix I to FRS 100):

- *EU Accounting Directive* – Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013;
- *CA 2006* – the Companies Act 2006;
- *Date of transition* – the beginning of the earliest period for which an entity presents full comparative information under a given standard in its first financial statements that comply with that standard;
- *EU-adopted IFRS* – IFRSs adopted in the European Union in accordance with EU Regulation 1606/2002 ('IAS Regulation');
- *IAS Regulation* – EU Regulation 1606/2002;
- *IFRS (or IFRSs)* – standards and interpretations issued or (adopted) by the International Accounting Standards Board (IASB). They comprise International Financial Reporting Standards, International Accounting Standards, Interpretations developed by the IFRS Interpretations Committee (the Interpretations Committee) or the former Standing Interpretations Committee (SIC);
- *Individual financial statements* – accounts that are required to be prepared by an entity in accordance with the CA 2006 or relevant legislation.

  For example, this term includes 'individual accounts' as set out in section 394 of the CA 2006, a 'statement of accounts' as set out in section 132 of the Charities Act 2011, or 'individual accounts' as set out in section 72A of the Building Societies Act 1986.

  Separate financial statements are included in the meaning of the term 'individual financial statements':

- *Micro-entities Regulations* – The Small Companies (Micro Entities' Accounts) Regulations 2013 (SI 2013/3008);
- *Non-financial Reporting Directive* – Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups;
- *Non-financial Reporting Regulations* – The Companies, Partnerships and Groups (Accounts and Non-financial Reporting) Regulations 2016 (SI 2016/1245). This Statutory Instrument primarily implements the requirements of the Non-financial Reporting Directive in the UK;
- *Qualifying entity* – a member of a group where the parent of that group prepares publicly available consolidated financial statements, which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation (as set out in section 474). For the purposes of FRS 101 only, a charity cannot be a qualifying entity. See Chapter 2 at 2.1 (for FRS 101) and Chapter 3 at 3.1 (for FRS 102);
- *Small entity* – (a) a company meeting the definition of a small company as set out in section 382 or 383 of the CA 2006[2] and not excluded from the small companies regime by section 384; (b) an LLP qualifying as small and not excluded from the small LLPs regime, as set out in the LLP Regulations; or (c) any other entity that would have met the criteria in (a) had it been a company incorporated under company law (see Chapter 5 at 4.1);
- *SI 2015/980* – The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 (SI 2015/980). This Statutory Instrument implements the requirements of the EU Accounting Directive (Directive 2013/34/EU) in the UK; and
- *SORP* – an extant Statement of Recommended Practice (SORP) developed in accordance with the FRC's *Policy on Developing Statements of Recommended Practice (SORPs)*.[3] SORPs recommend accounting practices for specialised industries or sectors, and supplement accounting standards and other legal and regulatory requirements in light of the special factors prevailing or transactions undertaken in a particular industry or sector.

Consistent with the FRS 102 Glossary, this chapter refers to *The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008* (SI 2008/409) as 'the Small Companies Regulations', and *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (SI 2008/410) as 'the Regulations'.

4 FRS 100 – APPLICATION OF FINANCIAL REPORTING REQUIREMENTS

The publication of FRS 100 to FRS 105 followed a lengthy period of consultation (from 2002 to 2012) on changes to financial reporting in the UK and Republic of Ireland (the 'Future of UK and Irish GAAP'). Further background on these consultations and the evolution of the FRC's approach leading up to the development of the new standards is included in Appendix III to the November 2012 version of FRS 100.

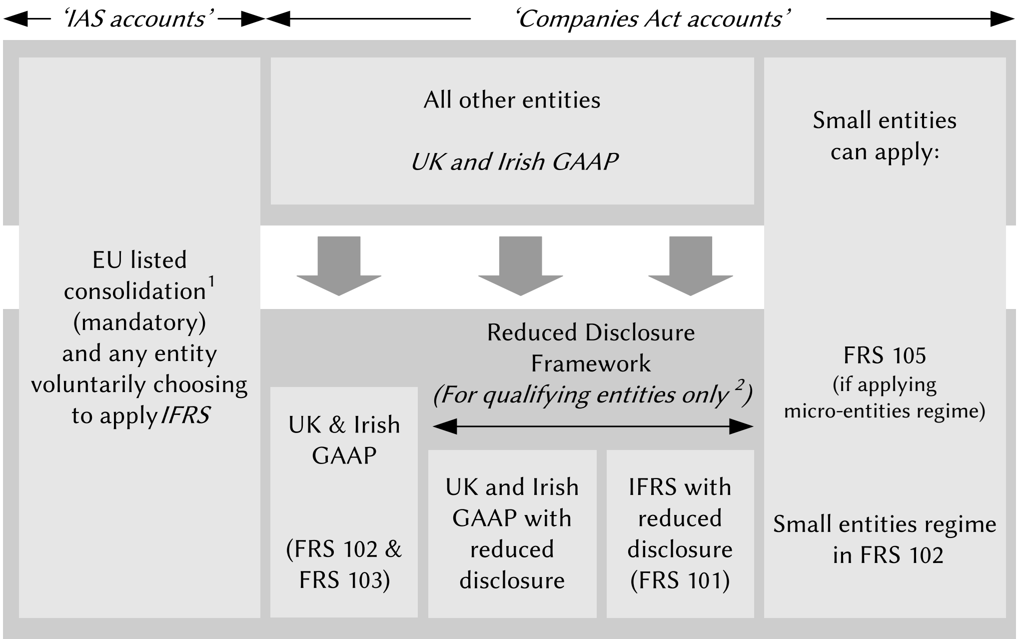
In developing the new standards, the FRC has set out an overriding objective to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. *[FRS 100.BC.1]*.

In meeting this objective, the FRC has stated that it aims to provide succinct financial reporting standards that: *[FRS 100.BC2]*

- have consistency with global accounting standards through application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
- balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;
- balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions based on size, complexity, public interest and users' information needs;
- promote efficiency within groups; and
- are cost-effective to apply.

The financial reporting framework set out in FRS 100 is summarised in the diagram below:

Figure 1.1 The UK Financial Reporting Framework



1: Consolidated financial statements of an entity with transferable securities admitted to trading on an EEA regulated market (See 4.4.1 below).

2: A qualifying entry (i.e. a parent or subsidiary undertaking) which is consolidated in publicly available consolidated financial statements that give a true and fair view can take advantage of the reduced disclosure framework. Applies to individual financial statements only and shareholders must be notified in writing about and not object to the disclosure exemptions. The IFRS 7, IFRS 13 and capital management disclosure exemptions (and in FRS 102, financial instruments-related disclosure exemptions) cannot be used by financial institutions.

4.1 Scope of FRS 100

The objective of FRS 100 is to set out the applicable financial reporting framework for entities presenting financial statements in accordance with legislation, regulations or accounting standards applicable in the UK and Republic of Ireland. *[FRS 100.1]*.

FRS 100 applies to financial statements intended to give a true and fair view of assets, liabilities, financial position and profit or loss for a period. *[FRS 100.2]*.

FRS 100 to FRS 105 can be applied by an entity that is not a UK or Irish company, preparing financial statements that are intended to give a true and fair view. However, Appendix II to FRS 100 states that the FRC sets accounting standards within the framework of the CA 2006 and therefore it is the company law requirements that the FRC primarily considered when developing FRS 102. See 4.4 below.

4.2 Effective date

FRS 100 to FRS 103 were mandatory for accounting periods beginning on or after 1 January 2015. In September 2015 new versions of FRS 100 to FRS 102 were issued reflecting various amendments made in July 2015 which were mandatory for accounting periods beginning on or after 1 January 2016. There were certain early application provisions (explained in Chapter 3 at 1.3.3 of EY UK GAAP 2017) that were intended to align with the application of SI 2015/980 (for UK companies).

In addition, a new standard, FRS 105, for entities applying the micro-entities regime was issued. FRS 105 is mandatory for a micro-entity choosing to apply the micro-entities regime for accounting periods beginning on or after 1 January 2016.

FRS 104 is not an accounting standard, and does not require an entity to prepare an interim report. It is intended for use in the preparation of interim reports by entities that prepare financial statements in accordance with UK GAAP. FRS 104 was originally issued in March 2015 and is effective for interim periods beginning on or after 1 January 2015, with early application permitted. FRS 104 is discussed in Chapter 34.

Following the Triennial review 2017, amendments were made to FRS 100 to FRS 105. The amendments to FRS 100, which are included in the March 2018 version of the standard, are effective for accounting periods beginning on or after 1 January 2019. Early application of the Triennial review 2017 amendments to FRS 100 are permitted provided that all the amendments are applied at the same time. *[FRS 100.10A]*.

For details of the Triennial review 2017 amendments affecting FRS 101, FRS 102, FRS 103 and FRS 104, see Chapters 2, 3, 5, 33 and 34.

4.3 Withdrawal of previous UK and Irish GAAP

FRS 100 withdrew all previous UK and Irish GAAP with effect from its application date. *[FRS 100.14]*. However, some parts of previous UK and Irish GAAP were retained by direct incorporation of their requirements into FRS 100 or FRS 102.

The following statements were also withdrawn when FRS 100 applied: *[FRS 100.15]*

- *Statement of Principles for Financial Reporting*;
- *Statement of Principles for Financial Reporting – Interpretation for public benefit entities*;
- *Reporting Statement: Retirement Benefits – Disclosures*;
- *Reporting Statement – Preliminary announcements*; and
- *Reporting Statement – Half-yearly financial reports* (replaced by FRS 104).

Separately, in June 2014, the FRC issued *Guidance on the Strategic Report* which superseded *Reporting Statement: Operating and Financial Review*. In July 2018, the FRC issued revised *Guidance on the Strategic Report* which supersedes the 2014 Guidance. The revised Guidance incorporates the new disclosure requirements introduced by the Non-financial Reporting Regulations which were effective for financial years beginning on or after 1 January 2017 and disclosures associated with the legislative requirements relating to the directors' section 172 duty to promote the success of the company, which are effective for financial years beginning on or after 1 January 2019.

The Financial Reporting Standard for Smaller Entities (effective January 2015) (FRSSE) was withdrawn for accounting periods beginning on or after 1 January 2016 (or on earlier application of SI 2015/980) and replaced by Section 1A of FRS 102. *[FRS 100.15A]*. See 4.4.5 below.

4.4 Basis of preparation of financial statements

FRS 100 does not address which entities must prepare financial statements, but sets out the applicable financial reporting framework for entities presenting financial statements in accordance with legislation, regulations or accounting standards applicable in the UK and Republic of Ireland. *[FRS 100.1]*.

The individual or consolidated financial statements of any entity within the scope of FRS 100 (that is not required by the IAS Regulation or other legislation or regulations to be prepared in accordance with EU-adopted IFRS) must be prepared in accordance with either: *[FRS 100.4]*

- FRS 105, if the entity is a micro entity eligible to apply that standard and chooses to do so – see 4.4.6 and 6.4 below; or
- if the financial statements are those of an entity that is not eligible to apply FRS 105:
  - EU-adopted IFRS (see 4.4.2 below); or
  - FRS 102 (see 4.4.3 below) and, where applicable, FRS 103 (see Chapter 33); or
  - FRS 101 (if the financial statements are individual financial statements of a qualifying entity) (see 4.4.4 below).

The above choices are also available for the individual financial statements of an entity that is required to prepare consolidated financial statements in accordance with EU-adopted IFRS. *[FRS 100.4, FRS 102.1.3]*.

An entity's choice of financial reporting framework must be permitted by the legal framework or other regulations or requirements that govern the preparation of the entity's financial statements. Other agreements or arrangements (such as shareholders' agreements, banking agreements) may also restrict the choice of financial reporting framework.

4.4.1 Company law and regulatory requirements governing financial reporting framework

As required by Article 4 of the IAS Regulation, a UK parent company with transferable securities admitted to trading on a regulated market at its financial year end must prepare its consolidated financial statements as IAS group accounts. *[s403(1)]*. The individual financial statements of such a parent company may be either Companies Act individual accounts or IAS individual accounts. *[s395(1)]*.

AIM is not a regulated market. An 'AIM company' (i.e. a company with a class of security admitted to AIM) incorporated in an EEA country (including, for this purpose, a company incorporated in the Channel Islands or the Isle of Man) must prepare and present its annual accounts in accordance with EU-adopted IFRS. However, an AIM company incorporated in an EEA country that is not a parent company at the end of the relevant financial period may prepare and present its annual accounts either in accordance with EU-adopted IFRS or in accordance with the accounting and company legislation and regulations that are applicable to that company due to its country of incorporation (which, under the new UK and Irish financial reporting framework, could include EU-adopted IFRS, FRS 101 – if a qualifying entity – and FRS 102). While the AIM Rules do not specifically differentiate between consolidated and individual financial statements, many AIM companies incorporated in the UK use EU-adopted IFRS in their consolidated financial statements but national GAAP in their individual financial statements. However, a parent company that only prepares individual financial statements, e.g. it is exempt from preparing consolidated financial statements, must prepare these in accordance with EU-adopted IFRS.[4]

For a UK company, the choice of framework, discussed at 4.4 above, is subject to the requirements in the CA 2006 on change in financial reporting framework (from IAS accounts to Companies Act accounts) (see 6.1.2 below) and consistency of financial reporting framework in individual accounts of group undertakings (see 6.1.3 below).

For the purposes of the CA 2006, only statutory accounts prepared in accordance with full EU-adopted IFRS are IAS accounts, whereas statutory accounts prepared in accordance with FRS 102, FRS 101, or FRS 105 are Companies Act accounts. *[s395(1), s403(2)]*.

UK charitable companies are not permitted to prepare IAS accounts under the CA 2006, *[s395(2), s403(3)]*, and charities are not permitted to apply FRS 101 (as excluded from its definition of a qualifying entity). *[FRS 100 Appendix I, FRS 101 Appendix I]*. UK charitable companies preparing financial statements under the CA 2006 must, therefore, apply FRS 102. Other charities in England and Wales and Scotland preparing financial statements under charities legislation must also apply FRS 102.

There is further detail on the requirements of the CA 2006 in relation to annual reports and accounts at 6 below.

FRS 101, FRS 102 and FRS 105 may also be used by entities preparing financial statements intended to give a true and fair view but that are not subject to the CA 2006 (or Irish law). Entities preparing such financial statements intended to give a true and fair view within other legal frameworks will need to satisfy themselves that the standard being applied does not conflict with any relevant legal obligations. *[FRS 100 Appendix II.20, FRS 102 Appendix III.41]*. Appendix III to FRS 100 and Appendix IV to FRS 102 include observations on the requirements of specific UK and Northern Ireland legislation, although some of this legislation may subsequently have been amended or superseded. Where an entity is subject to a SORP, the relevant SORP will provide more details on the relevant legislation. *[FRS 100 Appendix II.2, 21, FRS 102 Appendix III.2, 42]*.

4.4.2 EU-adopted IFRS

EU-adopted IFRS means IFRSs as adopted by the EU pursuant to the IAS Regulation. *[s474]*.

4.4.3 FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland

FRS 102 is a single, largely stand-alone, financial reporting standard based on a significantly modified version of the IFRS for SMEs issued by the IASB in 2009.

FRS 102 was originally issued in March 2013 but has had several subsequent amendments (see Chapter 3 at 1.2 and 1.3). A consolidated version of the standard issued in September 2015, incorporating the July 2015 amendments, was mandatory for periods beginning on or after 1 January 2016. Early application was permitted for accounting periods beginning on or after 1 January 2015 provided that the requirements of SI 2015/980 were applied from the same date.

A revised version of FRS 102 was issued in March 2018 (see Chapter 3 at 1.3 for details of the effective date) incorporating the following amendments made after the September 2015 version (which included the July 2015 and earlier amendments):

- *Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Ireland – Fair value hierarchy disclosures* issued in March 2016;
- *Amendments to FRS 101 Reduced Disclosure Framework and FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Notification of shareholders* issued in December 2016;
- *Triennial review 2017* issued in December 2017; and
- some minor typographical or presentational corrections.

Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Ireland – Directors' loans – optional interim relief for small entities issued in May 2017 provided an optional interim relief, with immediate effect, when accounting for loans made to a small entity by a director who is a natural person and a shareholder in the small entity (or a close member of the family of that person). These amendments were removed by the Triennial review 2017 (once applied) which include a more extensive relief. See Chapter 5 at 6.3.

FRS 102 is arranged into sections: Section 1 addresses scope, Sections 2 to 33 each address a separate accounting topic, Section 34 addresses specialised activities, and Section 35 – *Transition to this FRS* – addresses transition. There is a reduced disclosure framework available for qualifying entities (see 4.5 below) in their individual financial statements and also a separate disclosure framework for small entities introduced in July 2015 (see Chapter 5).

4.4.4 FRS 101 – Reduced Disclosure Framework

FRS 101 was issued originally on 22 November 2012. A consolidated version of the standard incorporating subsequent amendments was issued in September 2015 and was mandatory for accounting periods beginning on or after 1 January 2016, with certain early application provisions.

In March 2018, a revised edition of FRS 101 was issued which updates the September 2015 version for the following amendments (see Chapter 2 at 1.2):

- *Amendments to FRS 101 – Reduced Disclosure Framework 2015/16 cycle* issued in July 2016;
- Amendments to *FRS 101 Reduced Disclosure Framework and FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Notification of shareholders* issued in December 2016;
- *Amendments to FRS 101 – Reduced Disclosure Framework 2016/17 cycle* issued in July 2017;
- *Triennial review 2017 amendments* issued in December 2017; and
- some minor typographical or presentational corrections.

Amendments to Basis for Conclusions FRS 101 – Reduced Disclosure Framework – 2017/18 Cycle, issued in May 2018, made an amendment to the Basis for Conclusions in respect of IFRS 17 – *Insurance Contracts* – and updated Table 2 which sets out IFRS publications considered in the development of FRS 101. However, no changes were made to the standard itself.

See Chapter 2 at 1.2 for further details, including the circumstances in which the standard can be adopted early.

FRS 101 sets out a framework which addresses the financial reporting requirements and disclosure exemptions for the individual financial statements of qualifying entities (see 4.5 below) that otherwise apply the recognition, measurement and disclosure requirements of standards and interpretations issued by the International Accounting Standards Board (IASB) that have been adopted in the European Union (EU-adopted IFRS).

An entity reporting under FRS 101 complies with EU-adopted IFRS except as modified by the standard. FRS 101 contains various recognition and measurement modifications to EU-adopted IFRS, primarily to ensure compliance with UK company law.

The FRC will review FRS 101 annually to ensure that the reduced disclosure framework continues to be effective in providing disclosure reductions for qualifying entities when compared with EU-adopted IFRS. *[FRS 101.BC10]*.

4.4.5 Section 1A of FRS 102

Small entities can apply Section 1A of FRS 102. Section 1A was introduced in the July 2015 amendments to FRS 102 and is effective for accounting periods beginning on or after 1 January 2016 (see Chapter 5 at 5 for further details of effective date and early application). Section 1A requires small entities to apply the recognition and measurement requirements of FRS 102 in full. However, the presentation and disclosure requirements required by Section 1A are based on those required by the CA 2006 and the Small Companies Regulations for companies subject to the small companies regime.

The application of the small entities regime in Section 1A is not mandatory and an entity can instead apply FRS 102 in full, FRS 101 (if the entity is a 'qualifying entity' preparing individual financial statements – see Chapter 2), EU-adopted IFRS, or FRS 105 if subject to the micro-entities regime (see 4.4.6 below).

The small entities regime of FRS 102 is discussed in Chapter 5.

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

An entity that chooses to prepare its financial statements in accordance with the micro-entities regime (see 6.4 below) as set out in *The Small Companies (Micro-entities' Accounts) Regulations 2013 (SI 2013/3008)* is required to apply FRS 105 for periods beginning on or after 1 January 2016. Early application was permitted. FRS 105 was initially only available to UK companies, but was later extended to LLPs and Irish Companies. Amendments to FRS 105 were published in December 2017 as part of the Triennial Review 2017. The amendments mainly introduce new disclosure requirements and are effective for accounting periods beginning on or after 1 January 2019.

The recognition and measurement requirements of FRS 105 are based on those in FRS 102 (but with significant simplifications) and its presentation and disclosure requirements are consistent with the micro-entity provisions (in UK company and LLP law).

FRS 105 is outside the scope of this publication.

4.4.7 Considerations on choice of financial reporting framework

Entities will need to carefully consider their choice of financial reporting framework, based on their individual circumstances. In doing so, entities may need to consider the implications of a new financial reporting framework for other aspects of their business, such as covenants in loan agreements, employee remuneration (e.g. performance-related bonuses), the effect on key performance indicators, accounting systems, taxation and distributable profits.

Factors influencing the choice of financial reporting framework might include:

- whether the entity is a member of a group, and if so, what GAAP is used for group reporting. In particular, subsidiaries of groups reporting under IFRS or in multinational groups may prefer to apply IFRS or FRS 101 rather than FRS 102;
- the level of disclosures required in the financial statements.

  FRS 101 and FRS 102 financial statements prepared by a UK company are Companies Act accounts and therefore must comply with the requirements of the CA 2006 and all applicable schedules of the Regulations (as well as accounting standards). Financial statements prepared under EU-adopted IFRS do not need to comply with Schedules 1, 2 or 3 to the Regulations but must comply with the extensive disclosure requirements in IFRS (see 6.7 below).

  The level of disclosure also depends on whether the entity is a qualifying entity and can make use of a reduced disclosure framework (under FRS 101 or FRS 102) in its individual financial statements (see 4.5 below). While FRS 102 has fewer disclosures than IFRS, the level of disclosure required may sometimes not be significantly different from FRS 101, but this will depend on the entity's individual circumstances;
- stability of the financial reporting framework (in general, there are more frequent changes to IFRS than to FRS 102);
- the implications of new IFRSs (such as IFRS 9 – *Financial Instruments* – or IFRS 15 – *Revenue from Contracts with Customers* – or IFRS 16 – *Leases*) or expected changes to IFRS that will be implemented or expected to be finalised in future periods;
- IFRS provides detailed and sometimes complex guidance, whereas the requirements in FRS 102 are much shorter (but lack the same level of application guidance as in IFRS, and are likely to involve increased application of management judgement in applying the standard); and
- the implications of different GAAPs for distributable profits (see 5.5 below) and taxation, in particular cash tax. This will also depend on the interaction with tax legislation, and whether tax elections are made.

4.5 Reduced disclosure framework

Both FRS 101 and FRS 102 provide for a reduced disclosure framework for qualifying entities in individual financial statements.

A 'qualifying entity' is a member of a group (i.e. a parent or subsidiary) where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation. *[FRS 100 Appendix I, FRS 101 Appendix I, FRS 102 Appendix I].* The term 'included in the consolidation' has the meaning set out in section 474(1) of the CA 2006, i.e. that the qualifying entity is consolidated in the financial statements by full (and not proportional) consolidation. Under FRS 101, a charity cannot be a qualifying entity. *[FRS 101 Appendix I].*

The disclosure exemptions available in FRS 102 are more limited than in FRS 101, which provides a reduced disclosure framework for qualifying entities under EU-adopted IFRS. This reflects the fact that FRS 102 (as a starting point) has much simpler disclosures than EU-adopted IFRS. Under the reduced disclosure framework in both standards, there are fewer disclosure exemptions available for the individual financial statements of financial institutions.

Certain disclosures require 'equivalent' disclosures to be included in the publicly available consolidated financial statements of the parent in which the qualifying entity is consolidated (i.e. of the parent referred to in the definition of qualifying entity). FRS 100 provides guidance on the concept of 'equivalence' for these purposes. *[FRS 100.AG8-10]*.

Chapter 2 has further discussion of the reduced disclosure framework under FRS 101 and Chapter 3 discusses further the reduced disclosure framework under FRS 102, including the detailed requirements for its use, the definitions of 'qualifying entity' and 'financial institution', the disclosure exemptions available, and guidance on 'equivalence' for the purpose of the reduced disclosure framework.

4.6 Statement of compliance

FRS 100 requires that an entity preparing its financial statements in accordance with FRS 101 or FRS 102 (and where applicable, FRS 103) includes a statement of compliance in the notes to the financial statements in accordance with the requirements of the relevant standard. This requirement is not mandatory for a small entity applying the small entities regime in FRS 102 (Section 1A), although including a statement of compliance in the notes to the accounts is encouraged. *[FRS 100.9, FRS 103.1.12, FRS 102.3.3, FRS 101.10]*. See Chapter 2 at 1.3 (for FRS 101 financial statements), Chapter 6 at 3.8 (for FRS 102 financial statements), and Chapter 5 at 11.2.5 and 11.3 (for small entities under FRS 102).

This requirement is similar to that in IAS 1 – *Presentation of Financial Statements* – for an entity preparing its financial statements using EU-adopted IFRS to give an explicit and unreserved statement of compliance with IFRSs.

In the same way as required for IFRS financial statements, financial statements should not be described as complying with FRS 101 or FRS 102, unless they comply with *all* of the requirements of the relevant standard. Indeed, FRS 102 includes an explicit requirement to this effect. *[FRS 102.3.3]*.

FRS 105 requires a statement, on the statement of financial position in a prominent position above the signature, that the financial statements are prepared in accordance with the micro-entity provisions. *[FRS 105.3.14, s414(3)]*.

4.6.1 Related Companies Act 2006 requirements

Where the directors of a large or medium-sized company (i.e. a company not subject to the micro-entity provisions or the small companies regime – see 6.4 and 6.5 below) prepare Companies Act individual or group accounts (such as those prepared under FRS 101 and FRS 102), the notes to the accounts must include a statement as to whether the accounts have been prepared in accordance with applicable accounting standards. Particulars of any material departure from those standards and the reasons for the departure must be given. This statement is not required in the individual accounts of medium-sized companies (see 6.6.2.A below). *[Regulations 4(2A), 1 Sch 45]*.

'Applicable accounting standards' means statements of standard accounting practice issued by the FRC (and SSAPs, FRSs issued by the Accounting Standard Board and UITF

Abstracts, until withdrawn).[5] Therefore, FRS 100 to FRS 103 (and FRS 105 for companies applying the micro-entity provisions only) are 'applicable accounting standards'.[6]

Where the directors of a company prepare IAS individual or IAS group accounts (see 6.1 below), the notes to the accounts must include a statement that the accounts have been prepared in accordance with international accounting standards (i.e. EU-adopted IFRS). *[s397, s406, s474]*.

4.7 SORPs

References to a SORP are to an extant Statement of Recommended Practice developed in accordance with the FRC's *Policy on Developing Statements of Recommended Practice (SORPs)*. SORPs recommend accounting practices for specialised industries or sectors. They supplement accounting standards and other legal and regulatory requirements in the light of the special factors prevailing or transactions undertaken in a particular industry or sector. *[FRS 100 Appendix I]*.

SORPs may only be developed and issued by 'SORP-making bodies', being bodies recognised by the FRC for the purpose of producing the SORP for a particular industry or sector. SORP-making bodies have a responsibility to act in the public interest when developing a SORP. To be recognised as a SORP-making body, a particular industry or sectoral body must meet criteria set by the FRC and must agree to develop SORPs in accordance with the FRC's Policy on Developing Statements of Recommended Practice (SORPs). SORPs recommend particular accounting treatments and disclosures with the aim of narrowing areas of difference and variety between comparable entities. Compliance with a SORP that has been generally accepted by an industry or sector leads to enhanced comparability between the financial statements of entities in that industry or sector. Comparability is further enhanced if users are made aware of the extent to which an entity complies with a SORP, and the reasons for any departures. *[FRS 100.7]*.

FRS 100 states that if an entity's financial statements are prepared in accordance with FRS 102, SORPs apply in the circumstances set out in those SORPs. *[FRS 100.5]*.

The application of SORPs under FRS 102 is discussed at Chapter 3 at 2.3.

When a SORP applies, an entity, other than a small entity applying the small entities regime in FRS 102 (i.e. Section 1A of FRS 102), must state in the financial statements the title of the SORP and whether the financial statements have been prepared in accordance with the SORP's provisions currently in effect. The provisions of a SORP cease to have effect, for example, to the extent they conflict with a more recent financial reporting standard. *[FRS 100.6]*.

Paragraph 6 of the FRC's Policy on Developing Statements of Recommended Practice (SORPs) explains that SORPs should be developed in line with current accounting standards and best practice. A SORP's provisions cannot override provisions of the law, regulatory requirements or accounting standards. Therefore, where at the time of issue, the SORP's provisions conflict with accounting standards or legal or regulatory requirements, these take precedence over the SORP and the FRC's Statement on the SORP will usually be varied to refer to this. When a more recently issued accounting standard or change in legislation leads to conflict with the provisions of an existing SORP, the relevant provisions of the SORP cease to have effect. The SORP-making body is responsible for updating the relevant provisions of the SORP on a timely basis to bring them in line with new legislation or accounting standards, or to withdraw them, as appropriate.

Where an entity departs from the SORP's provisions, it must give a brief description of how the financial statements depart from the recommended practice set out in the SORP, which must include: *[FRS 100.6]*

- for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the entity's particular circumstances; and
- brief details of any disclosures recommended by the SORP that have not been provided, together with the reasons why not.

A small entity applying the small entities regime in FRS 102 is encouraged to provide these disclosures. *[FRS 100.6]*.

The effect of a departure from a SORP need not be quantified, except in those rare cases where such quantification is necessary for the entity's financial statements to give a true and fair view. *[FRS 100.7]*.

Entities whose financial statements do not fall within the scope of a SORP may, if the SORP is otherwise relevant to them, nevertheless choose to comply with the SORP's recommendations when preparing financial statements, providing that the SORP does not conflict with the requirements of the framework adopted. Where this is the case, entities are encouraged to disclose this fact. *[FRS 100.8]*.

FRS 100, therefore, does not require an entity preparing its financial statements in accordance with FRS 101, or EU-adopted IFRS, to disclose whether it has applied the relevant SORP. However, FRS 100 does not preclude such an entity from following a SORP (provided its requirements do not conflict with EU-adopted IFRS) but encourages the entity to disclose that it has done so.

4.7.1 Status of SORPs

Certain SORPs were withdrawn on implementation of the new UK and Irish GAAP framework. Other SORPs have been updated to conform with FRS 102 (although two Charities SORPs have been issued, one for use with the FRSSE and one for use with FRS 102).

The following SORPs have been updated to conform with FRS 102:

- *Accounting for Further and Higher Education* (October 2018);
- *Financial Statements of UK Authorised Funds* (May 2014, as amended in June 2017);
- *Charities (FRS 102)* (July 2014, as updated Update Bulletin 1 in February 2016 and Update Bulletin 2 in October 2018);
- *Limited Liability Partnerships* (January 2017);
- *Registered Social Housing Providers* (September 2014);
- *Investment Trust Companies and Venture Capital Trusts* (November 2014, as updated in February 2018); and
- *Pension Schemes* (July 2018).

Refer to Chapter 3 at 2.3 for further details on the application of SORPs.

As a consequence of the December 2017 amendments to FRS 102 following the triennial review, all seven SORP-making bodies have either updated, or are in the process of updating, their respective SORPs to reflect the amendments. At the time of writing only the Pensions Scheme SORP has been updated. A draft version of the updated Limited Liability Partnerships SORP was published in August 2018 for consultation.

4.8 Brexit

On 29 March 2017, the UK Government started the legal process of negotiating a withdrawal by the UK from the European Union (EU). Under the provisions of the relevant laws and treaties, the UK will leave the EU by 29 March 2019, unless either a deal is reached at an earlier date, or the negotiation period is extended by unanimous consent of the European Council. Until that date, the UK remains a member of the EU and all laws and regulations continue to apply on that basis. On 14 November 2018 a *Draft Agreement on the Withdrawal of the United Kingdom from the European Union* was published. At the time of writing this publication, the draft agreement is subject to approval of the UK parliament. This approval is uncertain. Other scenarios remain a possibility.

Many requirements that derive from EU legislation, treaties and directives have been directly incorporated into UK company law. As a result, even in the event of EU legislation ceasing to apply, UK financial and reporting regulations will not change until applicable company law and regulations are amended. In particular, the application of EU adopted IFRS is enshrined in the CA 2006 and nothing will change in that respect without a change to the CA 2006.

The Accounts and Reports (Amendment) (EU Exit) Regulations 2018 were laid in draft before Parliament on 31 October 2018. This draft Statutory Instrument amends certain provisions of the CA 2006 that refer to the EU, EEA or entities within these areas. The timing of the effective date of this proposed legislation depends on whether or not a transition period is agreed with the EU.

The UK will also need to establish its policy on the endorsement of future IFRSs. It appears likely, at the time of writing this chapter, that a UK endorsement process will be established although any details have yet to be published.

Given the uncertain nature of the final terms of the UK's withdrawal from the EU, the final form of the draft legislation above and the extent of further legislative and regulatory changes in the UK affecting the financial reporting framework, are subject to change.

4.9 Future development of FRS 102

Any amendments to FRS 102 to reflect major changes in IFRS will be considered by the FRC on a case-by-case basis, including the appropriate timing. In addition, FRS 102 will be subject to periodic reviews reflecting stakeholder feedback, minor changes in IFRS and the IFRS for SMEs and other issues. These periodic reviews are likely to take place every four to five years, to allow time for experience of the most recent edition of FRS 102 to develop before seeking stakeholder feedback. However, the FRC will continue to assess emerging issues as they arise to determine whether action needs to be taken. When necessary this will include issuing amendments to standards outside regular review cycles. *[FRS 102.BC.A44-45]*.

5 TRANSITION

FRS 100 sets out the requirements for transition to FRS 101, FRS 102 and FRS 105. The requirements differ depending on the standard transitioned to and whether the entity previously reported under EU-adopted IFRS or other GAAP (e.g. another form of UK GAAP).

The date of transition is the beginning of the earliest period for which an entity presents full comparative information under a given standard in its first financial statements which comply with that standard. *[FRS 100 Appendix I]*. Therefore, 1 January 2018 is the date of transition for an entity with a 31 December year-end which prepares its first IFRS (or FRS 101 or FRS 102) financial statements for the financial year ended 31 December 2019.

Before deciding to transition to a particular standard in the new UK and Irish GAAP framework, entities should assess whether this is permitted by the statutory framework or other regulation that applies to them. See 6.1 and 6.2.1.D below for considerations applicable to the CA 2006.

On first-time application of FRS 100 or when an entity changes its basis of preparation of its financial statements within the requirements of FRS 100, it should apply the transitional arrangements relevant to its circumstances as explained at 5.1 to 5.3 below.

There is no requirement to change the GAAP applied by a UK parent and its UK subsidiaries at the same time. However, the CA 2006 sets out restrictions over changes in financial reporting framework (in both individual and group accounts) and over consistency of financial reporting framework in individual accounts of group undertakings (see 6.1.2 and 6.1.3 below).

5.1 Transition to EU-adopted IFRS

An entity transitioning to EU-adopted IFRS must apply the transitional requirements of IFRS 1 – *First-time Adoption of International Financial Reporting Standards*, as adopted by the EU. *[FRS 100.11(a)]*.

An entity's first IFRS financial statements (to which IFRS 1 must be applied) are the first annual financial statements in which the entity adopts EU-adopted IFRS, by an explicit and unreserved statement in those financial statements of compliance with EU-adopted IFRS. *[IFRS 1.2-3]*.

An entity that has applied EU-adopted IFRS in a previous reporting period, but whose most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with EU-adopted IFRS must either apply IFRS 1 or else apply EU-adopted IFRS retrospectively in accordance with IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* – as if the entity had never stopped applying IFRSs. *[IFRS 1.4A]*.

The requirements of IFRS 1 are discussed in Chapter 5 of EY International GAAP 2019.

5.2 Transition to FRS 101

A qualifying entity can transition to FRS 101 from either EU-adopted IFRS or another form of UK or Irish GAAP. In this context, another form of UK or Irish GAAP means FRS 102 or FRS 105. The transition requirements differ depending on whether the qualifying entity is applying EU-adopted IFRS or not prior to the date of transition. *[FRS 100.11(b), 12-13]*. The transition requirements to FRS 101 are explained in Chapter 2 at 3.

5.3 Transition to FRS 102

A first-time adopter of FRS 102 is an entity that presents its first annual financial statements that conform to FRS 102, regardless of whether its previous financial reporting framework was EU-adopted IFRS or another set of GAAP such as its national accounting standards, or another framework such as the local income tax basis. *[FRS 102.35.1, Appendix I]*. An entity transitioning to FRS 102 must apply the transitional arrangements set out in Section 35 of the standard. *[FRS 100.11(c), FRS 102.35.1]*.

FRS 102 also addresses the situation where an entity has previously applied FRS 102, and then applies a different GAAP for a period before re-applying FRS 102. An entity that adopted FRS 102 in a previous reporting period but whose most recent annual financial statements did not contain an explicit and unreserved statement of compliance with FRS 102 must either apply Section 35 or else apply FRS 102 retrospectively in accordance with Section 10 – *Accounting Policies, Changes in Estimates and Errors*, as if the entity had never stopped applying the standard. *[FRS 102.35.2]*.

An entity applying FRS 102 is required to apply FRS 103 to insurance contracts (including reinsurance contracts) that the entity issues and reinsurance contracts that the entity holds, and to financial instruments (other than insurance contracts) that the entity issues with a discretionary participation feature. *[FRS 103.1.2]*. An entity may, therefore, apply FRS 103 at the same time as it adopts FRS 102 or after it has adopted FRS 102, depending on whether it has transactions within scope of FRS 103 on adoption of FRS 102. It is not, however possible to apply FRS 103 without also applying FRS 102. *[FRS 103.1.11]*. See Chapter 33.

5.4 Transition to FRS 105

A first time adopter of FRS 105 is an entity that presents its first annual financial statements that conform to FRS 105, regardless of its previous financial reporting framework. *[FRS 105 Appendix I]*. In practice, most first time adopters of FRS 105 are likely to have previously applied Section 1A of FRS 102. An entity transitioning to FRS 105 must apply the transitional arrangements set out in Section 28 – *Transition to this FRS* – of FRS 105. *[FRS 100.11(d), FRS 105.28.3]*.

As noted in 4.4.6 above, the application of FRS 105 is outside the scope of this publication.

5.5 Impact of transition on distributable profits

There may be circumstances where a conversion to FRS 101, FRS 102, FRS 105 or EU-adopted IFRS eliminates an entity's realised profits or even turns those realised profits into a realised loss. TECH 02/17BL – *Guidance on realised and distributable profits under the Companies Act 2006*, issued by the ICAEW and ICAS, states that the change in the treatment of a retained profit or loss as realised (or unrealised) as a result of a change in the law or in accounting standards or interpretations would not render unlawful a distribution already made out of realised profits determined by reference to 'relevant accounts' which had been prepared in accordance with principles accepted at the time that the accounts are prepared (subject to the considerations below). This is because the CA 2006 defines realised profits and realised losses for determining the lawfulness of a distribution as 'such profits or losses of the company as fall to be treated as realised in accordance with principles generally accepted at the time when the accounts are prepared, with respect to the determination for accounting purposes of realised profits or losses'. *[s853(4), TECH 02/17BL.3.28-3.29]*.

The effects of the introduction of a new accounting standard or of the adoption of IFRSs (or FRS 101, FRS 102 or FRS 105) become relevant to the application of the common law capital maintenance rule only in relation to distributions accounted for in periods in which the change will first be recognised in the accounts. This means that a change in accounting policy known to be adopted in a financial year needs to be taken into account in determining the dividend to be approved by shareholders in that year. Therefore, for example, an entity converting to a new financial reporting framework (FRS 101, FRS 102, FRS 105, or EU-adopted IFRS) in 2019 must have regard to the effect of adoption of the new financial reporting framework in respect of all dividends payable in 2019, including any final dividends in respect of 2018, even though the 'relevant accounts' may still be those for 2018 prepared under another GAAP. These considerations apply to all dividends whether in respect of shares classified as equity or as debt (or partly equity or debt). *[TECH 02/17BL.3.30-3.33]*.

There is no requirement to prepare statutory 'interim accounts' under sections 836(2) and 838 of the CA 2006 (and delivered to the Registrar if the company is a public company) if a proposed distribution can be justified by reference to the relevant accounts. However, under common law, a company cannot lawfully make a distribution out of capital and the directors may therefore consider preparing non-statutory 'interim accounts' using the new financial framework to ascertain that there are sufficient distributable profits and, if the company is a public company, that the net asset restriction in section 831 of the CA 2006 is not breached. *[TECH 02/17BL.3.35]*. In some cases, however, the directors may be satisfied that no material adjustments arise from transition to the new financial framework (and therefore that there are sufficient distributable profits) without preparing such 'interim accounts'. Statutory 'interim accounts' would be required if transition to a new financial reporting framework increases distributable profits and the directors wish to make a distribution not justified by reference to the relevant accounts. *[TECH 02/17BL.3.34-35, 37]*. TECH 02/17BL states that if the directors have not yet decided whether to adopt EU-adopted IFRS, say, for the current financial year, the company's accounting policies are those that it has previously applied until a decision is made to change them. Therefore, in applying the above, it is not necessary to have regard to possible changes of policy that are being considered but have not yet been agreed. *[TECH 02/17BL.3.36]*.

Distributable profits are discussed more generally at 6.8 below.

6 COMPANIES ACT 2006

6.1 Basis of preparation of financial statements

The directors of every company (except certain dormant subsidiary undertakings that qualify for exemption from preparation of accounts – the criteria are set out in sections 394A to C) must prepare individual accounts for the company for each financial year (see 6.2 below). *[s394]*. The directors of a parent company must prepare group accounts, unless there is an exemption available from preparation of group accounts (see 6.3 below).

Directors must not approve accounts unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and in the case of group accounts, of the undertakings included in the consolidation as a whole, so far as concerns members of the company. *[s393]*. See 7.2 below for a discussion of accounting standards and 'true and fair'.

6.1.1 Choice of IAS accounts and Companies Act accounts under the CA 2006

The CA 2006 distinguishes between IAS accounts and Companies Act accounts. Financial statements prepared in accordance with the CA 2006 using EU-adopted IFRS are IAS accounts. Financial statements prepared in accordance with the CA 2006 using FRS 101, FRS 102 or FRS 105 are Companies Act accounts.

See 6.2 below for the requirements for IAS accounts and Companies Act accounts.

A company's individual accounts may be prepared:

- in accordance with section 396 (Companies Act individual accounts); or
- in accordance with EU-adopted IFRS (IAS individual accounts). *[s395(1)]*.

This is subject to the restrictions on changes of financial reporting framework and the requirements for consistency of financial reporting framework within the individual accounts of group undertakings (see 6.1.2 and 6.1.3 below).

The group accounts of certain parent companies are required by Article 4 of the IAS Regulation to be prepared in accordance with EU-adopted IFRS. *[s403(1)]*. Article 4 of the IAS Regulation requires an EEA-incorporated company with securities admitted to trading on a regulated market (as at its financial year end) to prepare its consolidated financial statements in accordance with EU-adopted IFRS.

The group accounts of other companies may be prepared:

- in accordance with section 404 (Companies Act group accounts); or
- in accordance with EU-adopted IFRS (IAS group accounts). *[s403(2)]*.

This is subject to the restrictions on changes of financial reporting framework (see 6.1.2 below).

The individual and any group accounts of a company that is a charity must be Companies Act accounts. *[s395(2), s403(3)]*.

6.1.2 CA 2006 restrictions on changes of financial reporting framework

Under the CA 2006, a company which wishes to change from preparing IAS individual accounts to preparing Companies Act individual accounts (such as financial statements prepared under FRS 101, FRS 102 or FRS 105) may do so only:

- if there is a relevant change of circumstance (see below); or
- for financial years ending on or after 1 October 2012, for a reason other than a relevant change of circumstance, provided the company has not changed to Companies Act individual accounts in the period of five years preceding the first day of that financial year. In calculating the five year period, no account is taken of a change made due to a relevant change of circumstance. *[s395(3)-(5)]*.

The same requirements apply where a company wishes to change from preparing IAS group accounts to preparing Companies Act group accounts, except that the references to individual accounts above are to group accounts. *[s403(4)-(6)]*.

These requirements enable a group where the parent and subsidiary undertakings prepare IAS individual accounts to instead prepare FRS 101 financial statements or even FRS 102 financial statements (as these are both Companies Act individual accounts) where the above criteria are met.

A relevant change of circumstance in respect of individual accounts occurs if, at any time during or after the first financial year in which the directors of a company prepare IAS individual accounts:

- the company becomes a subsidiary undertaking of another undertaking that does not prepare IAS individual accounts;
- the company ceases to be a subsidiary undertaking;
- the company ceases to be a company with securities admitted to trading on a regulated market in an EEA State; or
- a parent undertaking of the company ceases to be an undertaking with securities admitted to trading on a regulated market in an EEA State. *[s395(4)]*.

A relevant change of circumstance for the purposes of group accounts occurs if, at any time during or after the first financial year in which the directors of a parent company prepare IAS group accounts:

- the company becomes a subsidiary undertaking of another undertaking that does not prepare IAS group accounts;
- the company ceases to be a company with securities admitted to trading on a regulated market in an EEA State; or
- a parent undertaking of the company ceases to be an undertaking with securities admitted to trading on a regulated market in an EEA State. *[s403(5)]*.

Section 395's requirements in respect of individual accounts and section 403's requirements in respect of group accounts operate independently of each other. Therefore, an IFRS reporter would be permitted to move from IAS accounts to Companies Act accounts in its individual accounts, while continuing to prepare IAS group accounts.

Paragraph 9.18 of the June 2008 BERR document *Guidance for UK Companies on Accounting and Reporting: Requirements under the Companies Act 2006 and the application of the IAS regulation* notes that the first example of a relevant change in circumstance in the lists above is 'intended to deal with situations where a subsidiary undertaking is sold by a group generally using IAS, to another group or entity not generally using IAS. It is not intended that companies switch between accounting regimes on the basis of an internal group restructuring.'

The restriction is 'one-way' only from IAS accounts to Companies Act accounts. There is no restriction on the number of times a company can move from Companies Act accounts to IAS accounts or *vice versa* so theoretically a company could 'flip' from IAS accounts to Companies Act accounts and back again several times without a relevant change of circumstance provided it reverted back to Companies Act accounts no more than once every five years.

The CA 2006 does not restrict changes made between FRS 101, FRS 102 or FRS 105 since these are all Companies Act accounts.

6.1.3 Consistency of financial reporting framework in individual accounts of group undertakings

The CA 2006 requires that the directors of a UK parent company must secure that the individual accounts of the parent company and of each of its subsidiary undertakings are prepared under the same financial reporting framework, be it IAS accounts or Companies Act accounts, except to the extent that in the directors' opinion there are 'good reasons' for not doing so. *[s407(1)]*. However, this requirement does not apply:

- where the UK parent company does not prepare group accounts under the CA 2006; *[s407(2)]*
- to accounts of subsidiary undertakings not required to be prepared under Part 15 of the CA 2006 (e.g. accounts of a foreign subsidiary undertaking); *[s407(3)]* or
- to accounts of any subsidiary undertakings that are charities, *[s407(4)]*, (so charities and non-charities within a group are not required to use the same financial reporting framework in their accounts). Charities are not permitted to prepare either IAS group or IAS individual accounts. *[s395(2), s403(3)]*.

Additionally, a parent company that prepares both consolidated and separate financial statements under EU-adopted IFRS (i.e. IAS group accounts and IAS individual accounts) is not required to ensure that its subsidiary undertakings all prepare IAS individual accounts. However, it must ensure that its subsidiary undertakings use the same financial reporting framework (i.e. all prepare IAS accounts or all prepare Companies Act accounts) in their individual accounts unless there are 'good reasons' for not doing so. *[s407(5)]*.

Although not explicitly stated by FRS 100, there appears to be no requirement that all subsidiary undertakings in a group must use the same GAAP for their Companies Act individual accounts. Some could use, for example, FRS 101, and others could use FRS 102 since all are Companies Act individual accounts and therefore part of the same financial reporting framework. This approach would comply with the statutory requirements of Section 407. However, groups that use a 'mix' of GAAP in the individual financial statements may be challenged by HMRC, particularly if this results in tax arbitrage. Examples of 'good reasons' for not preparing all individual accounts within a group using the same financial reporting framework are contained in the June 2008 BERR document *Guidance for UK Companies On Accounting and Reporting: Requirements under the Companies Act 2006 and the application of the IAS regulation*. Paragraph 9.17 of the Guidance notes that this provision is intended to provide a degree of flexibility where there are genuine (including cost/benefit) grounds for using different accounting frameworks within a group of companies and identifies the following examples:

- 'A group using IAS acquired a subsidiary undertaking that had not been using IAS; in the first year of acquisition, it might not be practical for the newly acquired company to switch to IAS straight away.
- The group contains subsidiary undertakings that are themselves publicly traded, in which case market pressures or regulatory requirements to use IAS might come into play, without necessarily justifying a switch to IAS by the non-publicly traded subsidiaries.
- A subsidiary undertaking or the parent were planning to apply for a listing and so might wish to convert to IAS in advance, but the rest of the group was not planning to apply for a listing.
- The group contains minor or dormant subsidiaries where the costs of switching accounting framework would outweigh the benefits.

The key point is that the directors of the parent company must be able to justify any inconsistency to shareholders, regulators or other interested parties'.

6.2 Companies Act requirements for the annual report and accounts

Part 15 of the CA 2006 sets out the requirements for the annual report and accounts for UK companies.

The company's 'annual accounts' are the company's individual accounts for that year and any group accounts prepared by the company for that year.

Section 408 permits a parent company preparing group accounts (whether as IAS group accounts or Companies Act group accounts) to omit the individual profit and loss account from the annual accounts, where the conditions for this exemption are met (see 6.3.2 below). *[s471(1)]*.

References in Part 15 to the annual accounts (or to a balance sheet or profit and loss account) include notes to the accounts giving information required by any provision of the CA 2006 or EU-adopted IFRS, and that is required or allowed by any such provision to be given in a note to the company's accounts. *[s472]*.

The principal CA 2006 requirements for annual accounts are set out at 6.2.1 below and for the annual report at 6.2.2 below. While this chapter focuses on the disclosure requirements for UK companies, LLPs and other types of entities other than companies are also subject to similar statutory requirements. Reference should be made to the legislation that applies to such entities.

The Listing Rules, Disclosure and Transparency Rules or rules of the relevant securities market may require additional information beyond that required by the CA 2006 (and related regulations) to be included in the annual reports. For example, premium listed companies must state how they apply the main principles of, and present a statement of compliance or otherwise with the provisions of the UK Corporate Governance Code.[7] It is beyond the scope of this publication to cover such regulatory requirements.

6.2.1 Companies Act requirements for annual accounts

6.2.1.A Companies Act accounts

Companies Act individual accounts and Companies Act group accounts are prepared in accordance with sections 396 and 404 of the CA 2006 respectively. Companies Act accounts comprise:

- a balance sheet as at the last day of the financial year that gives a true and fair view of the state of affairs of the company (and in respect of group accounts, of the parent company and its subsidiary undertakings included in the consolidation as a whole, so far as concerns members of the company) as at the end of the financial year; and
- a profit and loss account that gives a true and fair view of the profit or loss of the company (and in respect of group accounts, of the parent company and its subsidiary undertakings included in the consolidation as a whole, so far as concerns members of the company) for the financial year. *[s396(1)-(2), s404(1)-(2)]*.

The accounts must comply with regulations as to the form and content of the company balance sheet and profit and loss account (and in respect of group accounts, of the consolidated balance sheet and consolidated profit and loss account) and additional information provided by way of notes to the accounts. *[s396(3), s404(3)]*.

These regulations are principally *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (Regulations), as amended. Companies subject to the small companies regime (see 6.5 below) are entitled to apply *The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008* (Small Companies Regulations), as amended. Micro-entities (see 6.4 below) are entitled to apply *The Small Companies (Micro Entities' Accounts) Regulations 2013* (Micro-entities Regulations), as amended.

If compliance with the regulations and any other provisions made by or under the CA 2006 as to the matters to be included in the accounts or notes to those accounts would not be sufficient to give a true and fair view, the necessary additional information must be given in the accounts or notes to the accounts. *[s396(4), s404(4)]*. If in special circumstances, compliance with any of those provisions is inconsistent with the requirement to give a true and fair view, the directors must depart from that provision to the extent necessary to give a true and fair view. Particulars of any such departure, the reasons for it and its effect must be given in a note to the accounts. *[s396(5), s404(5)]*. See Chapter 6 at 9.2 for further discussion of the 'true and fair override' provided for in the CA 2006 and FRS 102's requirements for a true and fair view.

6.2.1.B IAS accounts

Where the directors prepare IAS individual and/or IAS group accounts, they must state in the notes to those accounts that they have been prepared in accordance with EU-adopted IFRS. *[s397(2), s406(2), s474]*.

Where the section 408 exemption to omit the individual profit and loss account is taken where group accounts are prepared, the notes to IAS individual accounts must state that they have been prepared in accordance with EU-adopted IFRS as applied in accordance with the provisions of the CA 2006. See 6.3.2 below.

6.2.1.C General – Companies Act accounts and IAS accounts

There are two types of CA 2006 disclosures required for a UK company:

(a) those required by the Regulations (or other applicable regulations, as discussed below) for an entity preparing Companies Act accounts but not for an entity preparing IAS accounts (see 6.7.1 below); and

(b) those required for both IAS accounts and Companies Act accounts (see 6.7.2 below).

The CA 2006 distinguishes between companies that are micro-entities (see 6.4 below), companies subject to the small companies regime (see 6.5 below), and medium-sized companies (see 6.6 below).

The above categories of company are all based on meeting certain size criteria and not being excluded from the applicable regime. These companies benefit from a lighter disclosure regime in their financial statements than for large companies, i.e. the default category of companies that are not medium-sized companies, subject to the small companies regime or the micro-entities regime. Certain disclosure exemptions are available to companies preparing IAS accounts or Companies Act accounts, whereas others are only available to companies preparing Companies Act accounts. Companies subject to the small companies regime are entitled to follow the Small Companies Regulations and companies subject to the micro-entities regime are entitled to follow the Micro-entities Regulations (rather than the Regulations).

The CA 2006 also distinguishes between quoted and unquoted companies. While there is no difference in the disclosures required in the financial statements by the CA 2006 and the Regulations for quoted and unquoted companies, there are significant additional disclosures for quoted companies in the annual report (see 6.2.2 below). There are also disclosures only required to be given by companies with securities admitted to trading on a regulated market (see 6.2.2. below).

The CA 2006 requires that both Companies Act and IAS accounts group and individual accounts must give disclosures to explain the status of a company. A company must state: *[s396(A1), s397(1), s404(A1), s406(1)]*

- the part of the United Kingdom in which the company is registered;
- the company's registered number;
- whether the company is a public or private company and whether it is limited by shares or by guarantee;
- the address of the company's registered office; and
- where appropriate, the fact that the company is being wound-up.

A company's annual accounts must be approved by the board of directors and signed on behalf of the board by a director of the company, with the signature included on the company's balance sheet. *[s414(1)]*.

6.2.1.D Interaction of the Small Companies Regulations with FRS 101 and FRS 102

FRS 101 and FRS 102 (unless Section 1A is applied) do not permit use of the formats included in the Small Companies Regulations (see 6.5 below). *[FRS 101.5(b), AG1(h)-(i), FRS 102.4.2, 5.5, 5.7]*. However, a small entity that applies Section 1A of FRS 102 must present a statement of financial position and profit or loss in accordance with the requirements set out in Part 1 of Schedule 1 to the Small Companies Regulations or Part 1 of Schedule 1 to the Small LLP Regulations (except to the extent that these requirements are not permitted by any statutory framework under which such entities report). *[FRS 102.1A.4, 1A.12, 1A.14]*.

In our view, a company subject to the small companies regime which chooses to apply FRS 101, or which chooses to apply FRS 102 without applying Section 1A, is not precluded from taking advantage of other exemptions applicable to companies subject to the small companies regime. See Chapter 2 at 2.2 and Chapter 3 at 4.1.1.

Companies applying the micro-entity provisions (see 6.4 below) must apply FRS 105 (see 4.4.6 above).

6.2.2 Companies Act requirements for annual reports

The content of the annual report depends principally on whether the company is an unquoted company or a quoted company.

A quoted company means a company whose equity share capital:

- has been included in the Official List (as defined in section 103(1) of the Financial Services and Markets Act 2000) in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000; or
- is officially listed in an EEA State; or
- is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq.

A company is a quoted company in relation to a financial year if it is a quoted company immediately before the end of the accounting reference period (defined in section 391 of the CA 2006) by reference to which that financial year was determined. An unquoted company means a company that is not a quoted company. *[s385(1)-(3)]*.

The content of the annual reports and accounts of an unquoted and a quoted company are as follows:

- an unquoted company's annual accounts and reports comprise its annual accounts, strategic report (if required – see 6.2.2.B below), directors' report (unless a micro-entity – see 6.2.2.B below), any separate corporate governance statement and the auditor's report (unless the company is exempt from audit); and
- a quoted company's annual accounts and reports comprise its annual accounts, directors' remuneration report, strategic report, directors' report, any separate corporate governance statement, and the auditor's report.

Where the company is a parent company preparing group accounts, the directors' and strategic reports must be consolidated reports (i.e. a 'group directors' report' and 'group strategic report') relating to the undertakings included in the consolidation. These group reports may, when appropriate, give greater emphasis to the matters that are significant to the undertakings included in the consolidation. *[s414A-s414D, s415-s419]*.

In addition, companies with more than 500 employees that are traded companies, banking companies, authorised insurance companies and companies carrying on insurance market activity are required to comply with the Non-financial Reporting Regulations and must prepare a non-financial information statement within the strategic report. However, there are some scope exceptions (see 6.2.2.D below). The information should be provided on a consolidated basis for groups. *[s414CA-CB]*.

Entities are encouraged to meet the requirements of the non-financial information statement through a title and a series of cross-references, so as to maintain the coherence of the strategic report. Entities are discouraged from replicating information located elsewhere in the strategic report in the non-financial information statement.[8]

Small and medium-sized companies are entitled to certain exemptions (see 6.2.2.B below). Companies with securities admitted to a regulated market must make statutory corporate governance disclosures in the annual report and quoted companies have extended disclosures (see 6.2.2.C below). These include the Takeovers Directive disclosures required in the directors' report for companies with securities carrying voting rights admitted to trading on a regulated market at the financial year end. *[7 Sch 13]*. For large private companies, The Companies (Miscellaneous Reporting) Regulations 2018 (see 6.2.2.A) introduce a requirement to include disclosures of their corporate governance arrangements in the Directors' Report. AIM Rule 26 also requires that from 28 September 2018, AIM companies must provide details (on a website) explaining how they comply with, and where they depart from, a chosen 'recognised' corporate governance code.

A company's strategic report (if any), directors' report, directors' remuneration report (if any), and separate corporate governance statement (if any) must be approved by the board of directors and signed on behalf of the board by a director or the secretary of the company. *[s414D(1), s419(1), s419A, s422(1)]*.

It is beyond the scope of this publication to set out the content of the directors' report, strategic report, directors' remuneration report or corporate governance statement. In July 2018, the FRC published updated *Guidance on the Strategic Report.* The Guidance is intended to be persuasive rather than have mandatory force. In September 2016, the GC 100 and Investor Group published *Directors' Remuneration Report Guidance* which provides best practice guidance on the directors' remuneration report prepared by quoted companies.

In July 2018, Parliament approved the statutory instrument, The Companies (Miscellaneous Reporting) Regulations 2018 (SI 2018/860). The legislation introduces a wide range of disclosures, with varying applicability, discussed at 6.2.2.A below.

6.2.2.A The Companies (Miscellaneous Reporting) Regulations 2018

The disclosures required by The Companies (Miscellaneous Reporting) Regulations 2018 (SI 2018/860) are applicable to accounting periods beginning on or after 1 January 2019.

The main disclosure requirements introduced are:

- a statement in the strategic report to set out how directors have had regard to the matters set out in Section 172 (1) (a)-(f). Section 172 covers the directors' duty to promote the success of the company for the benefit of its members as a whole and sets out certain matters to which the directors' must have regard in doing this. This statement is called a 'section 172(1) statement' (applies to all companies that prepare a strategic report unless they qualify as medium-sized);
- the directors' report must detail how directors have engaged with employees, and the effect of their regard for employee interests on principal decisions taken by the company (applies to all companies with more than 250 UK employees or for companies that are parents, more than 250 UK employees in the group);
- the directors' report must summarise how directors have had regard for suppliers, customers and others, and the effect of that regard on principal decisions taken by the company (applies to any company which meets two or more of the following size criteria – turnover above £36m, balance sheet total of over £18m, more than 250 employees);
- a statement of corporate governance arrangements must be made in the directors' report detailing which corporate governance code the company applies (and how the code is applied, including explanations for any departure from application), and if no code is applied, why and what governance arrangements are in place (applies to all UK companies with either (a) more than 2,000 employees globally, and / or (b) turnover above £200m and a balance sheet of over £2bn. There are a number of exemptions. For example, companies required to prepare a statutory corporate governance statement under section 472A of CA 2006 (see 6.2.2.C) are exempt; and
- a 'pay ratios table' of executive pay to the first quartile, median and third quartile of employee pay. Where a company is a parent, the ratio information must relate to the group (applies to quoted companies with more than 250 UK employees or for quoted companies that are parents, with more than 250 UK employees in the group).

In addition, for quoted companies, there are a number of other amendments to directors' remuneration report requirements, including enhanced reporting on the impact of a share price change on executive pay awards.

Many of the disclosure requirements above that are subject to size thresholds are only required in the second year in which the company exceeds the relevant thresholds, however the specific requirements vary in each case so careful consideration will be required to determine whether the disclosure requirements are applicable in respect of a particular financial year.

6.2.2.B Exemptions for micro, small and medium-sized companies

The directors of a company must prepare a strategic report for the financial year unless the company is entitled to the small companies exemption (see 6.5 below). *[s414A(2), s414B]*.

There are certain disclosure exemptions available in respect of the strategic report for a medium-sized company (see 6.6 below).

All companies, except for micro entities, must prepare a directors' report for the financial year. *[s415]*. The exemption for micro entities was introduced following the implementation of the EU Accounting Directive. *[s415(1A)]*. A company subject to the small companies regime (see 6.5 below) is entitled to prepare the directors' report in accordance with the Small Companies Regulations which has significantly fewer disclosures than a directors' report prepared in accordance with the Regulations. *[s382-s384, 5 Sch (SC)]*. There are also certain disclosure exemptions available in respect of the directors' report for a company entitled to the small companies exemption. These exemptions are discussed in Chapter 5 at 12.2.

6.2.2.C Additional requirements for quoted companies and companies with transferable securities admitted to trading on a regulated market

The directors of a quoted company must prepare a directors' remuneration report for the financial year. *[s420-s422, 8 Sch 1]*.

A quoted company must also include additional disclosures in the directors' report (greenhouse gas disclosures) and strategic report compared to those required for an unquoted company. Additional disclosures for quoted companies in the strategic report include:

- the company's strategy and business model;
- gender diversity disclosures; and
- to the extent necessary for an understanding of the development, performance or position of the company's business:
  - the main trends and factors likely to affect the future development, performance and position of the company's business; and
  - certain information about environmental matters (including the impact of the company's business on the environment), the company's employees and social, community and human rights issues). *[s414C(7)-(10)]*.

Where group accounts are prepared, the information required relates to the undertakings included in the consolidation (i.e. the consolidated group) rather than the company, except that there are detailed requirements on the gender diversity disclosures required. *[s414C(10), (13)]*.

UK companies with transferable securities admitted to trading on a regulated market are required to prepare a statutory corporate governance statement. *[s472A]*. The requirements for the statutory corporate governance statement are included in the FCA's Disclosure and Transparency Rules (DTR) for a UK company, although the DTR extend the requirement to prepare a corporate governance statement to certain overseas listed companies, *[DTR 1B.1.4-1.6, DTR 7.2]*, and there may be corresponding requirements in other EEA states.

UK and overseas premium listed companies are also required to state how they apply the main principles of, and present a statement of compliance or otherwise with the provisions of the UK Corporate Governance Code.[9] This UK Corporate Governance Code statement overlaps with certain of the content requirements in DTR 7.2 for the statutory corporate governance statement (and with the required statement on audit committees included in DTR 7.1 which applies to issuers with securities admitted to trading on a regulated market required to appoint a statutory auditor, unless exempted from the requirements). *[DTR 1B.1.1-1.3, DTR 7.1]*.

In addition, the disclosures in DTR 7.2.8AR (diversity policy) must be made in the corporate governance statement required by DTR 7.2. The disclosures must explain the diversity policy applied to the issuer's administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds. In addition, the following must also be disclosed:

- the objectives of the diversity policy;
- how the diversity policy has been implemented; and
- the result of applying the policy in the reporting period.

The disclosures in DTR 7.2.8AR do not apply to:

(a) a company which has not issued shares admitted to trading, unless it has issued shares which are traded on an MTF (multilateral trading facility); or

(b) a company that qualifies as a small company (as defined in sections 382-382 CA 2006) or a medium company (as defined in sections 465-466 CA 2006 in the financial year; or

(c) an overseas company that would qualify as a small or medium company if it were incorporated in the UK. *[DTR.1B.1.6R-8R]*.

The statutory corporate governance statement can be included as part of the directors' report or as a separate corporate governance statement published together with and in the same manner as its annual report or on a website. *[DTR 7.2.9-11]*. A 'separate corporate governance statement' is defined as one not included in the directors' report, and therefore has its own approval and publication requirements. *[s472A(3)]*.

The directors' report of a company with securities carrying voting rights admitted to trading on a regulated market at the financial year end must include certain disclosures concerning the company's capital and control (Takeovers Directive disclosures). *[7 Sch 13]*. These disclosures are also required by DTR 7.2 as part of the statutory corporate governance statement.

6.2.2.D Additional requirements for Public Interest Entities ('PIEs')

PIEs are required to include a non-financial reporting information statement within the strategic report. A PIE is defined as an entity that, at any time in the financial year, is:

- a traded company (i.e. a company with transferable securities admitted to trading on a regulated market);
- a banking company;
- an authorised insurance company; or
- a company carrying on insurance market activity.

The non-financial information statement requirements were introduced in December 2016, by *The Companies, Partnerships and Groups (Accounts and Non-financial Reporting) Regulations 2016* (SI 2016/1245). This Statutory Instrument primarily implements the requirements of the Non-financial Reporting Directive in the UK. The requirement to prepare a non-financial reporting information statement are effective for companies (and qualifying partnerships) for financial years beginning on or after 1 January 2017.

The requirement applies where the company, or if the company is a parent company, the group, is not small (i.e. is not subject to the small companies regime in sections 382 to 384) or medium-sized (as set out in sections 465 to 467), and where the company or the group headed by the company has over 500 employees (average monthly total) in the financial year. However, subsidiary undertakings that are included in a group strategic report of its UK parent containing the non-financial information statement (or the consolidated management report /separate report of an EEA parent containing the information required by the Non-financial Reporting Directive) are exempt.

The non-financial information statement must contain information, to the extent necessary for an understanding of the company's development, performance and position and the impact of its activity, relating to, as a minimum:

- environmental matters (including the impact of the company's business on the environment);
- the company's employees;
- social matters;
- respect for human rights; and
- anti-corruption and anti-bribery matters.

The information disclosed must include:

(a) a brief description of the company's business model;

(b) a description of the policies pursued by the company in relation to the matters above and any due diligence process implemented by the company in pursuance of those policies;

(c) a description of the outcome of those policies;

(d) a description of the principal risks relating to the matters above arising in connection with the company's operations and, where relevant and proportionate:

  (i) a description of its business relationships, products and services which are likely to cause adverse impacts in those areas of risk, and

  (ii) a description of how it manages the principal risks; and

(e) a description of the non-financial key performance indicators relevant to the company's business.

6.3 Preparation of consolidated financial statements

The CA 2006 requires a UK company that is a parent company at its financial year end, to prepare group accounts (i.e. consolidated financial statements) unless otherwise exempt (see below). *[s399]*. A company that is exempt from the requirement to prepare group accounts may still do so. *[s399(4)]*.

A company that is subject to the small companies regime (or would be subject to the small companies regime except for it being a public company) is not required to prepare group accounts, but may do so. The exemption from preparing group accounts does not apply if the company is a member of a group which, at any time during the financial year, has an undertaking as a member which is established under the law of an EEA State, has to prepare its accounts in accordance with the EU Accounting Directive, and is an undertaking:

- which has been designated by an EEA State as a 'public-interest entity' under the EU Accounting Directive; or
- whose transferable securities are admitted to trading on a regulated market in an EEA State ('a traded company'); or
- which is a credit institution (as per Article 4(1)(1) of Regulation 575/2013 other than one listed in Article 2 of Directive 2013/36/EU); or
- which is an insurance undertaking (as per Article 2(1) of Directive 91/674/EEC). *[s399(2), s399(2A)-(2B)]*.

The other CA 2006 exemptions from preparation of group accounts comprise:

- Section 400 – parent company is a majority or wholly owned subsidiary undertaking whose immediate parent undertaking is established under the law of an EEA State, and is consolidated in group accounts of a larger group drawn up by an EEA parent undertaking (see Chapter 8 at 3.1.1.A);
- Section 401 – parent company is a majority or wholly owned subsidiary undertaking whose parent undertaking is not established under the law of an EEA State, and which is consolidated in group accounts of a larger group drawn up by a parent undertaking (see Chapter 8 at 3.1.1.B); and
- Section 402 – parent company, none of whose subsidiary undertakings need be included in the consolidation (see Chapter 8 at 3.1.1.E). *[s399(3)]*.

FRS 102 has been developed to be consistent with the requirements for group accounts (and exemptions) included in Part 15 of the CA 2006. Consequently, the detailed conditions for the above exemptions from preparing group accounts under the CA 2006 are discussed further in Chapter 8 at 3.1.1 and Chapter 5 at 6.2.

The application guidance to FRS 100 explains the use of equivalence in the context of the exemption from preparing consolidated financial statements under s401. This is discussed in Chapter 2 at 2.1.6 (FRS 101) and Chapter 8 at 3.1.1.C (FRS 102).

6.3.1 Requirements of accounting standards to prepare consolidated financial statements

FRS 100 does not address the requirements to prepare consolidated financial statements (nor do FRS 101 or FRS 105, since these standards only address individual financial statements).

EU-adopted IFRS and FRS 102 both include requirements on which entities should prepare consolidated financial statements, and how these should be prepared. Their requirements need to be read in conjunction with the requirements of the relevant statutory framework for preparation of the entity's financial statements.

FRS 102 requires an entity, that is a parent at its year end, to present consolidated financial statements in which it consolidates all its investments in subsidiaries in accordance with the standard (except those permitted or required to be excluded from consolidation) unless it is exempt from the requirement to prepare consolidated financial statements provided in the standard. *[FRS 102.9.2-9.3]*. As noted above, FRS 102's requirements to prepare group accounts (and exemptions) are consistent with the requirements of the CA 2006. A small entity that is a parent entity is not required to prepare consolidated financial statements under Section 1A of FRS 102 (see Chapter 5 at 6.2). *[FRS 102.1A.21]*. However, the CA 2006 is more restrictive than this, requiring a small entity that is a parent entity to prepare group accounts if the company is a member of a group which contains certain types of entities (see 6.3 above and Chapter 5 at 6.2).

6.3.2 Exemption from publishing the individual profit and loss account where group accounts are prepared

Where a company prepares group accounts in accordance with the CA 2006,

- the company's individual profit and loss account need not contain the information specified in paragraphs 65 to 69 of Schedule 1 to the Regulations (specified information supplementing the profit and loss account); and
- the company's individual profit and loss account must be approved by the directors in accordance with section 414(1) but may be omitted from the company's annual accounts.

This exemption is conditional on the company's individual balance sheet showing the company's profit or loss for the financial year (determined in accordance with the CA 2006) and use of the exemption conferred by section 408 being disclosed in the annual accounts. *[s408, Regulations 3(2)]*.

Example 1.1: Example of a s408 exemption statement

Basis of preparation

The group accounts consolidate the financial statements of ABC Limited (the company) and all its subsidiary undertakings drawn up to 31 December each year. No individual profit and loss account is presented for ABC Limited as permitted by section 408 of the Companies Act 2006.

[...]

Parent company balance sheet

The profit for the financial year of the company is £130,000 (2018: £111,000).

The exemption is available for both Companies Act and IAS group accounts. Paragraph 9.24 of the June 2008 BERR document *Guidance for UK Companies on Accounting and Reporting: Requirements under the Companies Act 2006 and the application of the IAS regulation* clarifies that:

'The omission of the profit and loss account (referred to within IAS as the income statement) might be considered to be inconsistent with certain aspects of IAS, for example, the requirement in IAS 1 *Presentation of Financial Statements* in relation to a fair presentation. However, IAS does not in itself require the preparation of separate financial statements but permits the omission of certain elements. In other words, the separate financial statements required to be published under the 2006 Act are an extract of the full IAS separate financial statements. This exemption should not affect the ability of a parent company to be treated as a "first-time adopter" and hence to take advantage of exemptions for first time use under the provisions of IFRS 1. The company will need to provide the disclosure required by section 408(4) i.e. that advantage has been taken of the publication exemption in section 408(1). The auditor will also need to describe the accounting framework that has been used within its audit reports. In respect of individual accounts, the reference to the framework will need to make clear that its basis is IAS as adopted by the EU as applied in accordance with the provisions of the 2006 Act.'

Paragraph 9.25 of the BERR guidance further notes that:

'The exemption in the 2006 Act relates only to the profit and loss account. By virtue of section 472(2), the exemption also extends to the notes to the profit and loss account. The individual IAS accounts would, however, still need to include the other primary statements and note disclosures required by IAS, including a cash flow statement and a statement of changes in shareholders' equity.'

6.4 Micro-entities regime

The voluntary regime for companies that are micro-entities was introduced into UK companies legislation by *The Small Companies (Micro-Entities' Accounts) Regulations 2013* (SI 2013/3008) (Micro-entities Regulations), and was effective for financial years ending on or after 30 September 2013 for companies filing their accounts on or after 1 December 2013. These regulations implemented the provisions of the EU Accounting Directive, which sets out certain minimum requirements for micro-entities into UK company law.

The Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016 (SI 2016/575), issued in May 2016, extended the scope of the micro-entities regime to LLPs and qualifying partnerships for accounting periods beginning on or after 1 January 2016 (early application was permitted for periods beginning on or after 1 January 2015).

In response to the introduction of the Micro-entities Regulations and the new financial reporting framework (see 1 above) the FRC issued FRS 105 (see 4.4.6 above). FRS 105 is outside the scope of this publication and 6.4.1 and 6.4.2 below only address the Companies Act requirements for micro-entities.

6.4.1 Scope of the micro-entities regime

A company or an LLP or qualifying partnership can only use the micro-entity provisions if it meets the size criteria and is not excluded from being treated as a micro-entity. The size criteria operate in the same way as for the small companies regime (see 6.5 below and Chapter 5 at 4.3).

The micro-entity provisions are not available to overseas companies and other entities. The Explanatory Note to the Micro-entities Regulations confirms that the regime is only available to companies formed and registered (or treated as formed and registered) under the CA 2006.

The qualifying conditions for UK entities are met in a year in which the entity satisfies two or more of the following requirements: *[s384A(4)-(7)]*

- turnover must not exceed £632,000;
- balance sheet total (gross assets) must not exceed £316,000; and
- the number of employees must not exceed 10.

In the case of an entity which is a parent entity, the entity qualifies as a micro-entity in relation to a financial year only if the entity qualifies as a micro-entity in relation to that year and the group headed by the entity qualifies as a small group. *[s384A(8)]*.

The micro-entity provisions do not apply to an entity's accounts for a particular financial year if the entity was at any time within that year: *[s384B(1)]*

- a company excluded from the small companies regime, or small LLPs regime, by section 384;
- an investment undertaking as defined in Article 2(14) of the EU Accounting Directive (Directive 2013/34/EU);
- a financial holding undertaking as defined in Article 2(15) of the EU Accounting Directive;
- a credit institution as defined in Article 4 of Directive 2006/48/EC (other than one referred to in Article 2 of that directive);
- an insurance undertaking as defined in Article 2(1) of Directive 91/674/EEC; or
- a charity.

The micro-entity provisions also do not apply in relation to an entity's accounts for a financial year if the entity is a parent company which prepares group accounts for that year as permitted by section 399(4), or is not a parent entity but its accounts are included in consolidated group accounts for that year. *[s384B(2)]*.

6.4.2 Companies Act requirements for micro-entities

The Micro-entities Regulations provide extensive presentation and disclosure exemptions for micro-entities (known as the micro-entity provisions). In summary, a micro-entity applies one of two abridged formats for the balance sheet and one abridged format for the profit and loss account, as set out in the Section C formats included in the Small Companies Regulations and presents limited prescribed notes which must be included at the foot of the balance sheet. *[s472(1A)]*. The formats and related notes disclosures are known as the 'micro-entity minimum accounting items'. *[s474(1)]*.

The prescribed notes comprise: information on directors' advances, credits and guarantees (required by s413); and on financial guarantees and commitments (required by 1 Sch 57 to the Small Companies Regulations). The micro-entity is not required to give any of the other information required by way of notes to the accounts set out in Schedules 1 to 3 to the Small Companies Regulations. This means there is no requirement to give the information on related undertakings set out in Schedule 2 or the disclosures on directors' remuneration set out in Schedule 3. *[Regulations (SC) 4, 5, 5A]*.

Micro-entities are not required to prepare a directors' report. *[s415(1A)]*.

The alternative accounting rules and fair value accounting rules (explained further in Chapter 6 at 10) do not apply where the micro-entity provisions are applied; therefore a micro-entity applying the micro-entity provisions is not permitted to revalue tangible fixed assets, investment properties or financial instruments.

In considering whether the individual accounts give a true and fair view, the directors apply the following provisions:

- where the accounts comprise only micro-entity minimum accounting items, the directors must disregard any provision of an accounting standard which would require the accounts to contain information additional to those items;
- in relation to a micro-entity minimum accounting item contained in the accounts, the directors must disregard any provision of an accounting standard which would require the accounts to contain further information in relation to that item; and
- where the accounts contain an item of information additional to the micro-entity minimum accounting items, the directors must have regard to any provision of an accounting standard which relates to that item. *[s393(1A)]*.

Even though the presentation and disclosure requirements are minimal, 'the micro-entity minimum accounting items' included in the company's accounts for the year are presumed to give the true and fair view required (the usual requirements to give additional information where the matters required to be included in the accounts are not sufficient to give a true and fair view and the provisions on 'true and fair override' do not apply in relation to the micro-entity minimum accounting items included in the company's accounts for the year).

The auditor of a company which qualifies as a micro-entity in relation to a financial year applies the same provisions above in considering whether the individual accounts of the company for that year give a true and fair view. *[s495(3A)]*.

If the accounts are prepared in accordance with the micro-entity provisions, the balance sheet must contain a statement to this effect in a prominent place above the signature(s) of the director(s). *[s414(3)(a)]*.

Companies using the micro-entity provisions must file a copy of their accounts at Companies House. *[s444(3)]*. Micro-entities can use the filing exemptions for companies subject to the small companies regime (subject to making the statement that the accounts (and reports) have been delivered in accordance with the provisions applicable to companies subject to the small companies regime). *[s444(1)-(2), (5)]*.

6.4.3 Micro-entities in the Republic of Ireland

Equivalent legislation to the Micro-entities Regulations (see 6.4 above) was signed into Irish law in May 2017 (with a commencement date of 9 June 2017) as part of the Companies (Accounting) Act 2017. The Companies (Accounting) Act 2017 is mandatory for accounting periods beginning on or after 1 January 2017, but the micro-entities provisions can be adopted by Irish companies for periods beginning on or after 1 January 2015.

The qualifying conditions for Irish entities are different to those for UK entities (see 6.4.1 above) and are met in a year in which the entity satisfied two or more of the following requirements: *[FRS 105 Appendix IV.4]*

- turnover must not exceed €700,000;
- balance sheet total (gross assets) must not exceed €350,000; and
- the number of employees must not exceed 10.

Certain companies are excluded from being treated as micro companies, including those excluded from the small companies regime, investment undertakings, financial holding undertakings, holding companies voluntarily preparing consolidated financial statements and subsidiaries included in consolidated financial statements. The Companies Act 2014 should be referred to for a full list of excluded companies. *[FRS 105 Appendix IV.4]*.

6.5 Small companies

There are two sets of exemptions available for small companies:

- the small companies regime – which applies to the preparation and/or filing of the financial statements; and
- the small companies exemption – which applies to the preparation and/or filing of the strategic report and directors' report.

The small companies regime and small companies exemption under the Companies Act are discussed in Chapter 5 at 12. This discussion is relevant to both companies preparing Companies Act accounts (such as those prepared in accordance with FRS 101 and FRS 102) and IAS accounts (in accordance with EU-adopted IFRS).

Chapter 5 also addresses the requirements in Section 1A of FRS 102 for entities subject to the small entities regime.

6.6 Medium-sized companies and groups

Medium-sized companies and groups must apply the Regulations in preparing their annual reports and accounts. A medium-sized company may take advantage of certain disclosure exemptions in its annual reports and accounts for a financial year in which the company qualifies as medium-sized and is not an excluded company. *[s465-467]*.

There is no requirement for the annual reports and accounts of a medium-sized company to state use of the disclosure exemptions.

6.6.1 Qualification as medium-sized company

The medium-sized companies regime works in the same way as the small companies regime (described in Chapter 3 at 4.1.2). The size criteria and excluded companies are detailed below.

6.6.1.A Size criteria for medium-sized companies and groups

A company qualifies as medium-sized in relation to its first financial year if the qualifying conditions are met in that year. *[s465(1)]*.

A group qualifies as medium-sized in relation to a subsequent financial year if the qualifying conditions are met in that year. *[s465(2)]*. In relation to a subsequent financial year, where on its balance sheet date a company meets or cease to meet the qualifying conditions, then that will affect its qualification as a medium-sized company only if it occurs in two consecutive years. *[s465(3)]*.

Where the company itself is a parent undertaking, then it only qualifies as medium-sized if the group that it heads qualifies as a medium-sized group. This is the case whether or not group accounts are prepared. A group qualifies as medium-sized in relation to its first financial year if the qualifying conditions (as set out below) are met in that year. In relation to a subsequent financial year, where on its balance sheet date a group meets or ceases to meet the qualifying conditions, then that will affect its qualification as a medium-sized company only if it occurs in two consecutive years. *[s466]*.

The qualifying conditions for a medium-sized company are met in a year in which the company satisfies two or more of the following requirements: *[s465]*

- turnover must not exceed £36 million;
- balance sheet total (gross assets) must not exceed £18 million; and
- the number of employees must not exceed 250.

The qualifying conditions for a medium-sized group are met in a year in which the group headed by the company satisfies two or more of the following requirements: *[s466]*

- turnover must not exceed £36 million net (or £43.2 million gross);
- balance sheet total must not exceed £18 million (or £21.6 million gross); and
- the number of employees must not exceed 250.

The aggregate figures for the above limits are ascertained by aggregating the relevant figures determined in accordance with section 466 for each member of the group. The figures used for each subsidiary undertaking are those included in its individual accounts for the relevant financial year. That is, where its financial year is coterminous with that of the parent company, the financial year that ends at the same date as the parent company, or where its financial year is not coterminous, the financial year ending last before the end of the financial year of the parent company. If those figures are not obtainable without disproportionate expense or undue delay, the latest available figures are used.

The turnover and balance sheet total criteria may be satisfied on either the gross or net of consolidation adjustments basis. For Companies Act accounts (such as FRS 102 financial statements), the consolidation adjustments are determined in accordance with regulations made under section 404, i.e. the Regulations. For IAS accounts, the consolidation adjustments are determined in accordance with EU-adopted IFRS. It is permissible to satisfy one limit on the 'net' basis and the other on the 'gross' basis. *[s466(4)-(7)]*.

6.6.1.B Companies excluded from medium-sized companies

A company is not entitled to take advantage of any of the provisions available for companies qualifying as medium-sized if it was at any time within the financial year to which the accounts relate:

- a public company;
- a company that has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on a regulated activity;
- a company that carries on an insurance market activity;
- an e-money issuer; or
- a member of an ineligible group. *[s467(1)]*.

A group is ineligible if any of its members is:

- a traded company;
- a body corporate (other than a company) whose shares are admitted to trading on a regulated market in an EEA State (as defined in Directive 2004/39/EC);
- a person (other than a small company) who has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on a regulated activity;
- an e-money issuer;
- a small company that is an authorised insurance company, banking company, a MiFID investment firm or a UCITS management company; or
- a person who carries on an insurance market activity. *[s467(2)]*.

A company is a small company for the purposes of section 467(2) if it qualified as small in relation to its last financial year ending on or before the end of the financial years to which the accounts relate. *[s467(3)]*.

The reference to a 'company' above is to a company formed and registered (or treated as formed and registered) under the CA 2006. This means a company formed and registered under the CA 2006, or prior to 1 October 2009 under the Companies Act 1985, Companies (Northern Ireland) Order 1986 or former Companies Acts (i.e. an 'existing company' for the purposes of that Act and Order). *[s1]*.

A public company means a company limited by shares or limited by guarantee and having a share capital (a) whose certificate of incorporation states that it is a public company and (b) in relation to which the requirements of the CA 2006 or former Companies Acts as to registration or re-registration as a public company have been complied with (on or after the relevant date, being 22 December 1980 in Great Britain and 1 July 1983 in Northern Ireland). *[s4]*. Therefore, a public company means a UK-incorporated company that is a 'plc' or 'PLC' rather than a publicly traded company.

A traded company means a company any of whose transferable securities are admitted to trading on a regulated market. *[s474]*.

An authorised insurance company is defined in section 1165(2), a banking company in section 1164(2)-(3) and insurance market activity in section 1165(7). See Chapter 6 at 4.2.2 and 4.2.3.

The terms e-money issuer, MiFID investment firm, regulated activity, and UCITS management company are defined in section 474 of the CA 2006. The term 'e-money issuer' means an electronic money institution within the meaning of *The Electronic Money Regulations 2011* (SI 2011/99) or a person who has permission under Part 4A of the Financial Services and Markets Act 2008 (c 8) to carry on the activity of issuing electronic money within the meaning of article 9B of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 20101/544). *[s474]*.

A body corporate includes a body incorporated outside the UK but does not include (a) a corporation sole or (b) a partnership that, whether or not a legal person, is not regarded as a body corporate under the law by which it is governed. *[s1173(1)]*. Therefore, a body corporate would include an overseas company or a UK LLP.

6.6.2 Disclosure exemptions available for medium-sized companies

6.6.2.A Disclosure exemptions available in the accounts and reports prepared for members

The disclosure exemptions for medium-sized companies include:

- no requirement to disclose non-financial key performance indicators, including information relating to environmental matters and employee matters, in the strategic report; *[s414C(6)]*
- no requirement for Companies Act individual accounts to disclose the information required by paragraph 45 (the statement that the accounts have been prepared in accordance with applicable accounting standards, giving particulars and reasons for any material departures from these standards) or paragraph 72 (related party disclosures) of Schedule 1 to the Regulations (see 4.6.1 above); *[Regulations 4(2A)-4(2B)]*
- no requirement to disclose auditor's remuneration in respect of non-audit services. Like companies subject to the small companies regime, only remuneration for the auditing of the annual accounts receivable by the company's auditor (but not the associates of the auditor) is required to be disclosed. *[s494]*.[10] TECH 14/13 FRF – *Disclosure of auditor information* – provides guidance on disclosure of auditor remuneration; and
- certain exemptions from disclosures required by The Companies (Miscellaneous Reporting) Regulations 2018 (see 6.2.2.A above).

Medium-sized entities preparing financial statements in accordance with FRS 101 or FRS 102 must still give the disclosures required by accounting standards, e.g. medium-sized companies still need to give the related party disclosures required by accounting standards.

6.6.2.B Abbreviated accounts

There is no option for medium-sized companies to deliver abbreviated accounts to the Registrar. Refer to Chapter 5 at 13 for details of the filing requirements for small companies.

6.7 Disclosures

The CA 2006 (particularly Part 15), the Regulations and other statutory instruments include disclosure requirements which apply to Companies Act accounts and IAS accounts. As discussed at 6.7.1 below, only some parts of the Regulations apply to IAS accounts. See 6.7.2 for a list of Companies Act disclosures applicable to both IAS accounts and Companies Act accounts.

The disclosure exemptions for companies subject to the small companies regime in the CA 2006 and the Small Companies Regulations are addressed in Chapter 5.

6.7.1 Disclosures required by the Regulations

The Regulations contain the following schedules:

- Schedule 1 (Companies Act individual accounts – companies other than banking and insurance companies);
- Schedule 2 (Companies Act individual accounts: banking companies);
- Schedule 3 (Companies Act individual accounts: insurance companies);
- Schedule 4 (Information about related undertakings – Companies Act or IAS accounts);
- Schedule 5 (Information about directors' benefits: remuneration – Companies Act or IAS accounts);
- Schedule 6 (Companies Act group accounts);
- Schedule 7 (Matters to be dealt with in directors' report);
- Schedule 8 (Directors' remuneration report – quoted companies);
- Schedule 9 (Definition of 'provisions'); and
- Schedule 10 (General interpretation).

A company preparing IAS individual accounts in accordance with section 397 (or IAS group accounts in accordance with section 406) does not apply Schedules 1 to 3, or Schedule 6 to the Regulations.

A company preparing Companies Act accounts must comply with all the requirements of the Regulations, including Schedules 1 to 3 (as applicable) and, where group accounts are prepared, Schedule 6. Schedules 1 to 3 include the formats for the profit and loss account and balance sheet, recognition and measurement principles, and disclosure requirements. Schedule 1 applies to all companies (other than banking companies and insurance companies), Schedule 2 to banking companies and groups, and Schedule 3 to insurance companies and groups. See Chapter 6 at 4.2.2 and 4.2.3 for definitions of banking and insurance companies and groups respectively.

The Regulations require various disclosures to be given in the financial statements. In particular, Parts 3 of Schedules 1 to 3 for Companies Act accounts require certain disclosures to be made in the notes to the financial statements if not given in the primary statements. The relevant paragraphs are as follows:

- Schedule 1 paragraphs 42 to 72B;
- Schedule 2 paragraphs 52 to 92B;
- Schedule 3 paragraphs 60 to 90B; and
- Schedule 6 various paragraphs.

Although some of these disclosure requirements are replicated in EU-adopted IFRS, others are not. Entities that move to FRS 101 or FRS 102 from previous UK GAAP will have been required to provide the statutory disclosures required for Companies Act accounts previously and therefore these requirements will not increase their reporting burden. Entities that move to FRS 101 or FRS 102 from EU-adopted IFRS are required to provide the additional statutory disclosures for Companies Act accounts and should consider carefully the impact of these new requirements against the benefits of the reduced disclosures under those standards.

6.7.2 *Existing Companies Act disclosures in the accounts and reports applicable to IAS accounts and Companies Act accounts*

Companies preparing IAS accounts or Companies Act accounts are subject to the following disclosures:

- section 396(A1) and 397(1) – information about the status of the company where individual accounts are prepared. See 6.2.1.C above;
- section 404(A1) and 406(1) – information about the status of the company where group accounts are prepared See 6.2.1.C above; and
- section 409 (and Schedule 4 to the Regulations) – information about related undertakings;
- section 410A – off-balance sheet arrangements (unless subject to the small companies regime). See Chapter 6 at 8.7;
- section 411 – employee numbers and costs (unless subject to the small companies regime). See Chapter 6 at 8.6;
- section 412 (and Schedule 5 and paragraph 22A of Schedule 6 to the Regulations) – directors' benefits: remuneration;
- section 413 – directors' benefits: advances, credits and guarantees. See Chapter 6 at 8.8;
- section 414A-D – strategic report (including the non-financial information statement report disclosures required by section 414CA-CB for certain large public interest entities). The FRC's *Guidance on the Strategic Report* (June 2018) provides best practice guidance. This is intended to be persuasive rather than have mandatory force;
- section 236, sections 415 to 419 (and Schedule 7 to the Regulations) – directors' report;
- sections 420 to 421 (and Schedule 8 to the Regulations) – directors' remuneration report (quoted companies only). The GC 100 and Investor Group's *Directors' Remuneration Report Guidance 2016* (see 6.2.2 above), provides best practice guidance on the directors' remuneration report prepared by quoted companies; and
- section 494 (and *Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008*) – services provided by auditor and associates and related remuneration.

  Medium-sized companies are only required to disclose remuneration for the audit of the annual accounts receivable by the company's auditor (but not the associates of the auditor) and are not required to disclose remuneration for non-audit services. *[s494]*.[11]

TECH 14/13 FRF provides guidance on disclosure of auditor remuneration but does not reflect the amendments made by SI 2016/649[12]:

- to remove the requirement for companies subject to the small companies regime to disclose, in a note to the annual accounts, the amount of any remuneration receivable by the auditor for the auditing of those accounts.

  This disclosure remains for medium-sized companies; or
- to restrict the conditions for exemption for a subsidiary company, from disclosing information required by regulation (5)(1)(b) of SI 2008/489 (remuneration for

services other than the auditing of the company's accounts) in the subsidiary's individual accounts, to situations where the statutory auditor of the subsidiary company is the same as the statutory auditor of the parent that is required to prepare and does prepare group accounts in accordance with the CA 2006 (which consolidate the subsidiary).

The other conditions for use of this exemption by a subsidiary company are unchanged. There is also no change to the conditions for the same exemption for the individual accounts of a parent company.

LLPs may also have specific disclosure requirements, which are outside the scope of this publication.

In addition, other CA 2006 or related disclosures may apply depending on individual circumstances such as the disclosures required for a parent taking advantage of the exemption from preparing consolidated accounts under either sections 400 or 401 of the CA 2006.

6.8 Distributable profits

The determination of realised profits and losses and of profits available for distribution is governed by UK common law and statutory provisions. *[TECH 02/17BL.2.1]*. The ICAEW issued TECH 02/17BL – *Guidance on realised and distributable profits under the Companies Act 2006* – in April 2017. The purpose of the guidance is to identify, interpret and apply the principles relating to the determination of realised profits and losses for the purposes of making distributions under the Companies Act. *[TECH 02/17BL.1.1]*.

TECH 02/17BL is based on the previous guidance issued by the ICAEW and ICAS, TECH 02/10 – *Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2016*.

The main changes made by TECH 02/17 BL include:

- additional guidance on the definition of a distribution, highlighting that it is the purpose and substance of a transaction that matters in determining whether a distribution has been made, not the 'label' given to the transaction;
- new guidance on distributions in specie;
- new guidance on the impact of current and deferred tax on distributable profits;
- additional guidance on the impact on distributable profits of intra-group loans made at below market rates of interest;
- simplified guidance on the impact of retirement benefit schemes on distributable profits; and
- new guidance addressing distributable profits implications for long term insurance businesses.

A company may make a distribution only out of profits available for that purpose. A company's distributable profits are its accumulated realised profits (so far as not previously distributed or capitalised) less its accumulated realised losses (so far as not previously written off in a reduction or reorganisation of its share capital). Realised losses cannot be offset against unrealised profits. *[TECH 02/17BL.2.7]*. A further restriction is placed on public companies, which may only make a distribution if, after giving effect to such distribution, the amount of its net assets (as defined in section 831) is not less than the aggregate of its called up share capital and undistributable reserves (see section 831(4) for a list of undistributable reserves) as shown in the relevant accounts. *[s831]*.

Paragraph 13(a) of Schedule 1 to the Regulations (and its equivalents in Schedules 2 and 3 and the LLP Regulations) require that only profits realised at the balance sheet date are included in the profit or loss account. *[FRS 101 Appendix II.12, FRS 102 Appendix III.25]*. Consequently, profits that are not realised should normally be included in other comprehensive income rather than profit or loss in financial statements prepared under FRS 101 and FRS 102. However, paragraph 39 of Schedule 1 to the Regulations (and its equivalents in Schedules 2 and 3 and the LLP Regulations) allow stocks, investment property and living animals or plants to be held at fair value in Companies Act accounts. *[FRS 101 Appendix II.13, FRS 102 Appendix III.26]*. Paragraph 40(2) of Schedule 1 to the Regulations (and its equivalents in Schedules 2 and 3 and the LLP Regulations) require that movements in the fair value of financial instruments, investment properties or living animals and plants are recognised in the profit and loss account notwithstanding the usual restrictions allowing only realised profits and losses to be included in the profit and loss account. Therefore, paragraph 40 of Schedule 1 overrides paragraph 13(a) of Schedule 1 and such fair value gains can be recognised in profit and loss under FRS 101 and FRS 102. *[FRS 101 Appendix II.14, FRS 102 Appendix III.27]*.

The legal appendices to FRS 101 and FRS 102 both state that entities measuring investment properties, living animals or plants, or financial instruments at fair value may transfer such amounts to a separate non-distributable reserve instead of carrying them forward in retained earnings but are not required to do so. The FRC suggests that presenting fair value movements that are not distributable profits in a separate reserve may assist with the identification of profits available for that purpose. *[FRS 101 Appendix II.15, FRS 102 Appendix III.28]*.

Discussed below are some of the key terms and principles set out in TECH 02/17BL.

6.8.1 Realised profits

Profit is realised, as a matter of generally accepted accounting practice, where it arises from: *[TECH 02/17BL.3.9]*

(a) a transaction where the consideration received by the company is 'qualifying consideration' (see 6.8.2 below); or

(b) an event which results in 'qualifying consideration' being received by the company in circumstances where no consideration is given by the company; or

(c) the recognition in the financial statements of a change in fair value, in those cases where fair value has been determined in accordance with measurement guidance in the relevant accounting standards or company law, and to the extent that the change recognised is readily convertible to cash; or

(d) the translation of:

  (i) a monetary asset which comprises qualifying consideration; or

  (ii) a liability,

  denominated in a foreign currency; or

(e) the reversal of a loss previously regarded as realised; or

(f) a profit previously regarded as unrealised (such as amounts taken to a revaluation reserve, merger reserve, or other similar reserve) becoming realised as a result of:

 (i) consideration previously received by the company becoming 'qualifying consideration'; or

 (ii) the related asset being disposed of in a transaction where the consideration received by the company is 'qualifying consideration'; or

 (iii) a realised loss being recognised on the scrapping or disposal of the related asset; or

 (iv) a realised loss being recognised on the write-down for depreciation, amortisation, diminution in value or impairment of the related asset;

 (v) the distribution in kind of the asset to which the unrealised profit relates; or

 (vi) the receipt of a dividend in the form of qualifying consideration when no profit is recognised because the dividend is deducted from the book value of the investment to which the unrealised profit relates,

 in which case the appropriate proportion of the related unrealised profit becomes a realised profit; or

(g) the remeasurement of a liability, to the extent that the change recognised is readily convertible to cash.

If the write down in (f)(iv) above is subsequently reversed, an equal amount of profit should be regarded as becoming unrealised. In other words, the amount of profit regarded as becoming realised is equal to the cumulative amount of any write down treated as a realised loss.

In addition to those instances of realised profit included in the definition of realised profit set out above, the following would also constitute a realised profit per the guidance in TECH 02/17BL: *[TECH 02/17BL.3.14]*

(a) the receipt or accrual of investment or other income receivable in the form of qualifying consideration; or

(b) a gain arising on a return of capital on an investment where the return is in the form of qualifying consideration; or

(c) a gift (such as a 'capital contribution') received in the form of qualifying consideration. However, this does not apply when the legal form of the transaction is a loan even though it is accounted for as a capital contribution (see paragraph 6.20 of the TECH 02/17BL guidance regarding the proceeds of issue of convertible debt and paragraph 9.53 of the TECH 02/17BL guidance regarding intra-group off-market loans); or

(d) the release of a provision for a liability or loss which was treated as a realised loss; or

(e) the reversal of a write-down or provision for diminution in value or impairment of an asset which was treated as a realised loss.

6.8.2 Qualifying consideration

Qualifying consideration comprises: *[TECH 02/17BL.3.11]*

(a) cash; or

(b) an asset that is readily convertible to cash; or

(c) the release, or the settlement or assumption by another party, of all or part of a liability of the company; or

(d) an amount receivable in any of the above forms of consideration where:

  (i) the debtor is capable of settling the receivable within a reasonable period of time; and

  (ii) there is a reasonable certainty that the debtor will be capable of settling when called upon to do so; and

  (iii) there is an expectation that the receivable will be settled; or

(e) an amount receivable from a shareholder where and to the extent that:

  (i) the company intends to make a distribution to the shareholder of an amount equal to or less than its receivable from that shareholder; and

  (ii) the company intends to settle such distribution by off-setting against the amount receivable (in whole or in part); and

  (iii) within the meaning of paragraph 3.5 and 3.5A of the TECH 02/17BL guidance, (i) and (ii) are linked.

6.8.3 Realised losses

Losses should be regarded as realised losses except to the extent that the law, accounting standards or the guidance in TECH 02/17BL provide otherwise. *[TECH 02/17BL.3.10]*.

Realised losses will include: *[TECH 02/17BL.3.15]*

(a) a cost or an expense (other than one charged to the share premium account) which results in a reduction in recorded net assets;

(b) a loss arising on the sale or other disposal or scrapping of an asset;

(c) the writing down, or providing for the depreciation, amortisation, diminution in value or impairment, of an asset (except in the circumstances set out in paragraphs 2.33 and 2.36 of the TECH 02/17BL guidance);

(d) the creation of, or increase in a provision for a liability or loss (other than deferred tax arising in the circumstances discussed in paragraph 3.17 of the TECH 02/17BL guidance) which results in an overall reduction in recorded net assets;

(e) a gift made by the company (or the release of all or part of a debt due to that company or the assumption of a liability by the company) to the extent that it results in an overall reduction in recorded net assets; and

(f) a loss arising from fair value accounting where profits on remeasurement of the same asset or liability would be treated as realised profits.

6.8.4 Disclosure of distributable profits

Except for companies authorised to carry on long-term insurance business (e.g. life insurers), there is no requirement under UK law or accounting standards for financial statements to distinguish between realised and unrealised profits or between distributable profits and non-distributable profits. However, companies should maintain sufficient records to enable them to distinguish between those profits that are available for distribution and those which are not. *[TECH 02/17BL.2.25]*.

For companies authorised to carry on long-term insurance business, Schedule 3 to the Regulations requires that every balance sheet of such a company must show separately as an additional item the aggregate of any capital and reserves which are not required to be treated as realised profits under section 843 of the CA 2006. *[3 Sch 11(1)]*.

For companies authorised to carry on long-term insurance business in accordance with Article 14 of the Solvency 2 Directive, the realised profit or loss of the company in respect of which its relevant accounts are prepared is the amount calculated by a given formula. *[s833A]*. In summary, this formula is the company's net assets as calculated by the Solvency 2 Directive less share capital, share premium, any capital redemption reserve and any other reserve that the company is prohibited from distributing.

For companies that are not required to comply with the Solvency 2 Directive, realised profits or losses are determined using the normal UK common law and statutory requirements (see 6.8 above).

6.8.5 Impact of transition on distributable profits

The potential impact on distributable profits on transition to FRS 101, FRS 102 or FRS 105 is discussed at 5.5 above.

7 FINANCIAL REPORTING COUNCIL (FRC) AND ACCOUNTING STANDARD SETTING

This section draws on information concerning the FRC structure that is included on the FRC website.

The FRC Board is now supported by three governance committees (the Audit Committee, the Nominations Committee and the Remuneration Committee), two business committees (the Codes & Standards Committee and the Conduct Committee) and three advisory councils (Corporate Reporting, Audit & Assurance and Actuarial).

This chapter discusses the role of the FRC in accounting standard setting.

7.1 Accounting standards setting

Accounting standards are statements of standard accounting practice issued by such body or bodies prescribed by regulations.[13] *[s464(1)]*. Prior to 2 July 2012, this body was the Accounting Standards Board and from 2 July 2012, the Financial Reporting Council. New accounting standards, or amendments to or withdrawal of existing accounting standards must be approved by the FRC Board, having received advice from the Corporate Reporting Council and/or the Codes & Standards Committee (see below).

The FRC's objective in setting accounting standards is to enable users of accounts to receive high quality, understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. *[Foreword.8]*. The FRC collaborates with accounting standard setters from other countries and the IASB to influence the development of international accounting standards and to ensure that its standards are developed with due regard for international developments. The FRC works closely with the European Financial Reporting Advisory Group (EFRAG), which advises the European Commission on IFRSs in Europe and with the International Forum of Accounting Standard Setters (IFASS).

The Codes & Standards Committee, which contains both FRC Board members and others with particular technical expertise (including practising professionals) is responsible, *inter alia*, for advising the FRC Board on maintaining an effective framework of UK codes and standards for Corporate Governance, Stewardship, Accounting, Auditing and Assurance, and Actuarial technical standards. In relation to accounting standard setting, the FRC Board and the Codes & Standards Committee are advised by the Corporate Reporting Council (which is appointed by the Codes & Standards Committee). Its advice is put fully to the FRC Board, with the Board member chairing the Council responsible for submitting the Council's advice to the Board. The Corporate Reporting Council, which is appointed by the Codes & Standards Committee:

- provides strategic input and thought leadership, in the fields of accounting and financial reporting and in the work-plan of the FRC as a whole. This involves 'horizon-scanning' and consulting with practitioners or users;
- considers and advises the FRC Board upon draft codes and standards (or amendments thereto) to ensure that a high quality, effective and proportionate approach is taken;
- considers and comments on proposed developments in relation to international codes and standards and regulations; and
- considers and advises on research proposals and other initiatives undertaken to inform the FRC on matters material to its remit and any resultant publications.

In June 2013, the FRC established a UK GAAP Technical Advisory Group (TAG) to assist the Corporate Reporting Council. The TAG advises the Corporate Reporting Council on all issues relating to UK accounting standards, including areas where unsatisfactory or conflicting interpretations of accounting standards or Companies Act provisions have developed or seem likely to develop, as well as those relating to smaller entities.

The TAG also assists the Corporate Reporting Council in relation to the development of SORPs by SORP-making bodies by carrying out a limited review of a SORP (see 4.7 above). An Academic Panel also meets regularly to discuss issues relating to the FRC's work. The Corporate Reporting Council may also establish short-term advisory groups to provide input to specific projects.

The FRC's procedure for issuing accounting standards is set out in the *FRC Codes & Standards Committee: Procedures*.[14]

7.2 Scope and authority of accounting standards

The *Foreword to Accounting Standards*, last issued in March 2018, explains the authority, scope and application of accounting standards, known as Financial Reporting Standards (FRSs) issued by the FRC.

Accounting standards are applicable to the financial statements of a reporting entity that are required to give a true and fair view of its financial position at the reporting date; and of its profit or loss (or income and expenditure) for the reporting period. *[Foreword.4]*.

Accounting standards developed by the FRC are designated Financial Reporting Standards (FRSs). The FRC may issue FRSs that relate to other aspects of financial reporting, but which are not accounting standards. Each FRS will indicate its status, i.e. that it is an accounting standard or, if not, the circumstances in which it may be applied. *[Foreword.9-11]*. FRS 100 to FRS 103 and FRS 105 (but not FRS 104) are accounting standards for the purpose of company law.

Where exposure drafts are issued for comment and are subject to revision, until it is finalised as an accounting standard the requirements of any existing accounting standard that would be affected by proposals in the exposure draft remain in force. *[Foreword.13]*.

7.2.1 Accounting standards and true and fair

Section 393 of the CA 2006 requires that the directors of a company must not approve accounts unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss. *[s393]*.

Predecessor bodies to the FRC obtained legal opinions that have confirmed the centrality of the true and fair concept to the preparation and audit of financial statements, whether prepared in accordance with UK accounting standards or international accounting standards. The latest Opinion written by Martin Moore QC (2008) followed the enactment of the CA 2006 and the introduction of international accounting standards and endorsed the analysis in the earlier Opinions of Leonard Hoffman QC (1983) and Mary Arden (1984) and Mary Arden QC (1993) as to the approach that Courts would take to accounting standards when considering whether accounts show a true and fair view.

In October 2013, the then Department of Business, Skills and Innovation (BIS) published a ministerial statement:

'The Department of Business has given serious consideration to concerns raised by some stakeholders that accounts prepared over the past 30 years, in accordance with UK or international financial reporting standards, have not been properly prepared under UK and EU law.

'However, it is entirely satisfied that the concerns expressed are misconceived and that the existing legal framework, including international financial reporting standards, is binding under European Law.

'In preparing financial statements, achieving a true and fair view is and remains the overriding objective (and legal requirement). In the vast majority of cases, compliance with accounting standards will result in a true and fair view. However, where compliance with an accounting standard may not achieve that objective, accounting standards expressly provide that that standard may be overridden. [...]'

The FRC published its independent legal advice, available on the FRC website. The Opinion written by Martin Moore QC (3 October 2013) – *International Accounting Standards and the true and fair view* – considered issues addressed in an Opinion written by George Bompas QC (8 April 2013), in particular the interaction of

International Accounting Standards and the legal requirement that directors must not approve accounts that do not show a true and fair view, and the place of prudence.

However, both the FRC (in its Press Notice of 3 October 2013) and the BIS ministerial statement noted scope for improvements in aspects of international financial reporting standards and the IASB's Conceptual Framework, for example:

- stewardship reporting (i.e. holding directors to account for their management of the company's property) should be regarded as a primary objective of financial reporting;
- prudence (i.e. the exercise of caution), should be explicitly acknowledged in the Conceptual Framework; and
- there should be clear principles to describe when specific measurement bases, such as fair value (which needs to be appropriately defined) should be used. Performance reporting should present movements in fair value clearly and appropriately.

The FRC noted that investors raised other concerns and that it looked forward to working with investors and other stakeholders to address the full range of issues.

In June 2014, the FRC issued updated guidance – *True and Fair*. This confirms the fundamental importance of the true and fair requirement in both IFRS and UK GAAP, whether applying FRS 100 to FRS 103 or previous UK GAAP. This guidance emphasises the application of objective professional judgement, which applies at all stages of preparation of the financial statements, to ensure the financial statements give a true and fair view. The guidance specifically addresses the concept of prudence and reflecting the substance of transactions under both IFRS and UK GAAP.

The FRC expects preparers, those charged with governance and auditors to stand back and ensure that the financial statements as a whole give a true and fair view, provide additional disclosures where compliance with an accounting standard is insufficient to present a true and fair view, to use the true and fair override where compliance with the standards does not result in the presentation of a true and fair view and to ensure that the consideration they give to these matters is evident in their deliberations and documentation. See Chapter 6 at 9.2.

7.3 UK GAAP

UK GAAP is a wider concept than accounting standards, as defined at 7.2 above. For example, UK GAAP can include:

- SORPs (where an entity is within the scope of a SORP – see 4.7 above);
- other pronouncements issued by the FRC or its predecessor bodies (such as FREDs or best practice Reporting Statements) – providing these do not conflict with an extant accounting standard;
- pronouncements by authoritative bodies, such as Technical Releases issued by the Institute of Chartered Accountants in England and Wales and/or the Institute of Chartered Accountants in Scotland (examples include TECH 02/17BL); and
- generally accepted accounting practice where areas are not covered by specific accounting standards. This could include reference to the requirements of other bodies of GAAP where it addresses an issue, but does not conflict with accounting

standards. For example, FRS 102 permits but does not require management to refer to the requirements of EU-adopted IFRS dealing with similar and related issues in developing and applying a reliable and relevant accounting policy. *[FRS 102.10.6]*. Generally accepted accounting practice can also include established industry practice in accounting for transactions.

In addition, an entity must comply with any legal or regulatory requirements applicable to its annual report and financial statements, including the overall requirement for directors of a company to prepare accounts that give a true and fair view.

References

1 https://ec.europa.eu/info/node/7511

2 Irish small entities (including partnerships that are required to comply with Part 6 of the Companies Act 2014, by virtue of the European Communities (Accounts) Regulations 1993) should refer to sections 280A and 280B of the Companies Act 2014.

3 *Policy on Developing Statements of Recommended Practice (SORPs)*, Financial Reporting Council, October 2018.

4 AIM Rules, March 2018, para. 19, Glossary.

5 s464, *The Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc.) Order 2012* (SI 2012/1741).

6 *The Accounting Standards (Prescribed Bodies) (United States of America and Japan) Regulations 2015* (SI 2015/1675) permits companies with securities registered with the SEC or publicly traded on specified Japanese exchanges (but that do not have securities admitted to trading on an (EEA) regulated market) to prepare consolidated financial statements (but not individual financial statements) using US GAAP or JGAAP. Therefore, in these circumstances, US GAAP and JGAAP are applicable accounting standards. Such consolidated financial statements would also be Companies Act accounts. The Regulations, which replace a similar Statutory Instrument, come into force on 1 October 2015 and apply for financial years beginning on or after 1 January 2015. However, the dispensation applies only in respect of the group financial statements of a parent company for the first 4 financial years following incorporation of that company. It ceases to have effect on 30 September 2022.

7 Listing Rules, FCA, paras. 9.8.6(5), (6).

8 *Guidance on the Strategic Report*, Financial Reporting Council, July 2018, para. 7B.84.

9 Listing Rules, FCA, paras. 9.8.6(5), (6).

10 *The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008* (SI 2008/489), para. 4.

11 SI 2008/489, para. 4.

12 *The Statutory Auditors and Third Country Auditors Regulations 2016* (SI 2016/649), paras. 1(4), 18.

13 See footnote 4 above. *The Accounting Standards (Prescribed Bodies) (United States of America and Japan) Regulations 2015* extend the prescribed bodies for issuing accounting standards to include the FASB and the Accounting Standards Board of Japan for group accounts of parent companies with securities registered with the Securities Exchange Commission of the United States of America and specified Japanese exchanges respectively, with the restrictions set out in the statutory instrument.

14 https://www.frc.org.uk/About-the-FRC/Procedures/Regulatory-policies.aspx

Chapter 2 FRS 101 – Reduced disclosure framework

List of examples

Chapter 2 FRS 101 – Reduced disclosure framework

1 INTRODUCTION

This chapter deals only with the application of FRS 101 – *Reduced Disclosure Framework: Disclosure exemptions from EU-adopted IFRS for qualifying entities* – as issued in March 2018 and amended by *Amendments to Basis for Conclusions FRS 101 – Reduced Disclosure Framework 2017/18 cycle* issued in May 2018. References made to FRS 101 throughout this chapter are to the March 2018 edition of the standard unless otherwise indicated.

FRS 101 sets out a framework which addresses the financial reporting requirements and disclosure exemptions for the individual financial statements of subsidiaries and parents that otherwise apply the recognition, measurement and disclosure requirements of standards and interpretations issued by the International Accounting Standards Board (IASB) that have been adopted by the European Union (EU-adopted IFRS).

To use the framework in FRS 101, an entity needs to be a 'qualifying entity', i.e. a parent or subsidiary which is included in publicly available consolidated financial statements of its parent which are intended to give a true and fair view.

An entity preparing financial statements in accordance with FRS 101 ('FRS 101 financial statements') complies with EU-adopted IFRS except as modified in accordance with this FRS. This chapter does not discuss EU-adopted IFRS, which is covered in EY International GAAP 2019. The FRC's overriding objective is to enable users of accounts to receive high-quality, understandable financial reporting proportionate to the size and complexity of the entity and the users' information needs. In other words, the objective of FRS 101 is to enable the financial statements of subsidiaries and parents to be prepared under the recognition and measurement rules of EU-adopted IFRS, without the need for some of the copious disclosures which are perceived to act as a barrier to those entities preparing those financial statements under EU-adopted IFRS.

An entity using the reduced disclosure framework of FRS 101 is unable to make the explicit and unreserved statement that its financial statements comply with EU-adopted IFRS. This is because an accounting framework that allows such reduced disclosures cannot be described as EU-adopted IFRS. UK companies that prepare FRS 101 financial statements in accordance with Part 15 of the CA 2006 prepare Companies Act individual accounts as defined in s395(1)(a) of the CA 2006. This means that FRS 101 financial statements are subject to different Companies Act requirements from financial statements prepared under EU-adopted IFRS (which are IAS accounts prepared under s395(1)(b) of the CA 2006). In particular, FRS 101 financial statements prepared by a UK company must comply with Schedule 1, 2 (if a banking company) or 3 (if an insurance company) to *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (SI 2008/410), as amended ('the Regulations') – these schedules do not apply to IAS accounts. LLPs and certain other entities also prepare financial statements in accordance with Part 15 of the CA 2006 and are subject to similar requirements. Generally, this chapter refers to UK companies and the Regulations. The requirements for LLPs and *The Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008*, as amended ('the LLP Regulations') are similar, although there are some minor differences.

This chapter discusses FRS 101 only as it applies to UK companies, LLPs and other entities preparing financial statements under Part 15 of the Companies Act 2006 ('CA 2006'). However, FRS 101 may also be applied by non-UK entities currently applying IFRS as issued by the IASB, or another GAAP, although this may depend on local legislation (or regulatory or other requirements).

1.1 Summary of FRS 101

Application of FRS 101 can be summarised as follows:

- adoption of FRS 101 is voluntary, being one of a number of accounting standards available for financial reporting in the UK and Republic of Ireland (see Chapter 1);
- FRS 101 can only be applied in individual financial statements (see 2 below);
- FRS 101 can only be applied by a 'qualifying entity' (see 2.1 below);
- entities can transition to FRS 101 from IFRS or another GAAP (usually this will be from a form of UK GAAP) (see 3 below);
- entities using FRS 101 apply the recognition and measurement principles of EU-adopted IFRS, as amended by FRS 101 (see 4 below);
- entities using FRS 101 must prepare a balance sheet and profit and loss account (either as a separate income statement or as a section of the statement of comprehensive income) in accordance with the Regulations or, where applicable, the LLP Regulations. UK companies (other than banking or insurance companies) and LLPs may either apply statutory formats or adapted formats (which are based on IAS 1 – *Presentation of Financial Statements*) (see 5 below);
- entities using FRS 101 can take advantage of various disclosure exemptions from EU-adopted IFRS. Entities defined as 'financial institutions' have fewer exemptions than entities that are not financial institutions. Some of these disclosure exemptions are conditional on equivalent disclosures being included in the publicly available consolidated financial statements of the group in which the entity is consolidated and which are intended to give a true and fair view (see 6 below); and
- in addition to IFRS disclosures, entities using FRS 101 must comply with any legal requirements relating to financial statements, e.g. disclosures required by the CA 2006 and the Regulations, if subject to those requirements (see 7 below).

1.2 Effective date of FRS 101

FRS 101 was issued originally on 22 November 2012. Consolidated versions of the standard incorporating subsequent amendments were subsequently issued in August 2014, September 2015 and March 2018. The March 2018 version reflects the *Amendments to FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland – Triennial review 2017 – Incremental improvements and clarifications* issued in December 2017 (Triennial review 2017) discussed at 1.2.1 below. Subsequent to the March 2018 version of the standard, minor changes to the Basis for Conclusions have been made by *Amendments to Basis for Conclusions FRS 101 – Reduced Disclosure Framework 2017/18 cycle* issued in May 2018 (discussed at 1.2.2 below).

FRS 101 has been available for use for accounting periods beginning on or after 1 January 2015. Early application was permitted but was required to be disclosed. *[FRS 101.11]*.

The March 2018 version of FRS 101 is effective for accounting periods beginning on or after 1 January 2019. Early application of the March 2018 version of FRS 101 for accounting periods beginning prior to 1 January 2019 is permitted provided that all amendments made by the Triennial review 2017 are made at the same time. If an entity applies the Triennial review 2017 for an accounting period beginning before 1 January 2019 it shall disclose that fact. *[FRS 101.14]*.

Since FRS 101 is based on EU-adopted IFRS, any disclosure exemptions referring to a specific requirement of IFRS are effective only once the IFRS has been EU-adopted and is first applied by the entity. *[FRS 101.1, 8]*.

The FRC reviews FRS 101 annually to ensure that the reduced disclosure framework maintains consistency with EU-adopted IFRS. In addition, limited amendments have been made to FRS 101 (compared to EU-adopted IFRS) for compliance with the CA 2006 and the Regulations.

1.2.1 Amendments to FRS 101 incorporated into the March 2018 edition

The March 2018 edition of FRS 101 updates the edition of FRS 101 issued in September 2015 for all amendments to the standard issued between those dates. The amendments are as follows:

- *Amendments to FRS 101 – Reduced Disclosure Framework – 2015/16 cycle*, issued in July 2016, which:
  - provided disclosure exemptions in relation to IFRS 15 – *Revenue from Contracts with Customers* – which are applicable when an entity first applies IFRS 15 (see 6.1.6 below); *[FRS 101.8(eA)]* and
  - clarified that a qualifying entity preparing financial statements in accordance with FRS 101 should have regard to the legal requirement to present the notes to the financial statements in the order in which, where relevant, the items to which they relate are presented in the statement of financial position and the income statement when determining a systematic manner for the presentation of its notes to the financial statements in accordance with IAS 1. *[FRS 101 Appendix II.11A]*.
- *Amendments to FRS 101 – Reduced Disclosure Framework and FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland – Notification of Shareholders* issued in December 2016. These amendments

removed the requirement for a qualifying entity to notify its shareholders in writing of its intention to use the disclosure exemptions in FRS 101 (and under the reduced disclosure framework in FRS 102) and the ability of shareholders to object to the use of the disclosure objections. *[FRS 101.13]*.

- *Amendments to FRS 101 – Reduced Disclosure Framework – 2016/17 cycle* issued in July 2017, which:
  - provides disclosure exemptions in relation to IFRS 16 – *Leases* – which are applicable when an entity first applies IFRS 16 (see 6.1.7 below); *[FRS 101.8(eB)]* and
  - made amendments to reflect the EU endorsement of IFRS 9 – *Financial Instruments* – which are applicable from when an entity first applies IFRS 9 and the issue of *The Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016* (SI 2016/575) (see 4.2 and 4.11 below).
- Amendments made by the Triennial review 2017 issued in December 2017. These amendments apply for accounting periods beginning on or after 1 January 2019. Early application is permitted (but this must be disclosed) for accounting periods beginning prior to 1 January 2019 provided all amendments made by the Triennial review 2017 are applied at the same time.

  The principal amendment made is a change in the definition of a financial institution (see 6.4 below). As fewer entities are likely to meet the revised definition of a financial institution, some entities may wish to early adopt FRS 101 for this reason.

  There are also some minor typographical or presentational corrections or clarifications. These include guidance on presentation of a disposal group (see 5.1.2.B below) and a requirement that when paragraphs D16 and D17 of IFRS 1 – *First-time Adoption of International Financial Reporting Standards* –are applied, that the qualifying entity must ensure its assets and liabilities are measured in accordance with company law (see 3.4.1 and 3.4.2 below).

1.2.2 Amendments to FRS 101 issued in May 2018

Amendments to Basis for Conclusions FRS 101 – Reduced Disclosure Framework – 2017/18 Cycle made an amendment to the Basis for Conclusions in respect of IFRS 17 – *Insurance Contracts* (see 8.1 below) and updated Table 2 which sets out IFRS publications considered in the development of FRS 101. However, no changes were made to the standard itself.

1.3 Statement of compliance with FRS 101

A set of financial statements prepared in accordance with FRS 101 must contain a statement in the notes to the financial statements that 'These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework'. Since the standard does not comply with all of the requirements of EU-adopted IFRS, financial statements prepared in accordance with FRS 101 should not contain the unreserved statement of compliance referred to in paragraph 3 of IFRS 1 and otherwise required by paragraph 16 of IAS 1. *[FRS 101.10]*.

The Regulations require a large and medium-sized UK company (except a medium-sized company preparing individual accounts) preparing Companies Act accounts to state in the notes to the accounts whether the accounts have been prepared in accordance with applicable accounting standards, giving particulars of any material departure from those standards and the reasons for it. *[1 Sch 45]*. Financial statements prepared in accordance with FRS 101 are prepared in accordance with applicable accounting standards (which are defined in section 464 of CA 2006), *[s464]*, and therefore this statement would be required. See Chapter 1 at 4.6.1.

2 SCOPE OF FRS 101

FRS 101 may be applied to the individual financial statements of a 'qualifying entity' (see 2.1 below), that are intended to give a true and fair view of the assets, liabilities, financial position and profit or loss for a period. *[FRS 101.2]*.

Individual financial statements to which FRS 101 applies are accounts that are required to be prepared by an entity in accordance with the CA 2006 or relevant legislation, for example: individual accounts as set out in section 394 of the CA 2006 or as set out in section 72A of the Building Societies Act 1986. Separate financial statements, as defined by IAS 27 – *Separate Financial Statements*, are included in the meaning of the term individual financial statements. *[FRS 101 Appendix I]*. A charity, however, cannot apply FRS 101 (see 2.1 below).

This means that FRS 101 can be used in:

- individual financial statements of subsidiaries;
- separate financial statements of an intermediate parent which does not prepare consolidated financial statements; and
- separate financial statements of a parent which does prepare consolidated financial statements.

However, the entity applying FRS 101 must be included in a set of publicly available consolidated financial statements intended to give a true and fair view (see 2.1.6 below).

A parent company that prepares consolidated financial statements but applies FRS 101 in its separate financial statements can also use the exemption in the CA 2006 from presenting a profit and loss account and related notes in its individual financial statements, as well as taking advantage of the reduced disclosures from EU-adopted IFRS. *[s408]*.

FRS 101 cannot be applied in consolidated financial statements even if the entity preparing consolidated financial statements is a qualifying entity. *[FRS 101.3]*.

FRS 101 financial statements are not prepared in accordance with EU-adopted IFRS. A qualifying entity must ensure it complies with any relevant legal requirements applicable to it. Individual financial statements prepared by UK companies in accordance with FRS 101 are Companies Act accounts rather than IAS accounts as set out in section 395(1) of the CA 2006. Accordingly, UK companies that apply FRS 101 must comply with the requirements of the CA 2006 and any relevant regulations such as the Regulations. *[FRS 101.4A]*. The presentation requirements of relevant regulations applying to UK entities, including the requirements of the Regulations (which cover rules on recognition and measurement, the formats for the balance sheet and profit and loss account, and notes disclosures) are discussed in Chapter 6.

In order to ensure that FRS 101 financial statements comply with the CA 2006 and the Regulations, some limited recognition, measurement and presentational changes have been made in FRS 101 to EU-adopted IFRS. The amendments necessary to remove conflicts between EU-adopted IFRS, the CA 2006 and the Regulations are set out in paragraph AG1 of the Application Guidance to FRS 101. The standard emphasises that, for the avoidance of doubt, the Application Guidance is an integral part of the standard and is applicable to any qualifying entity applying FRS 101, not just to UK companies. *[FRS 101.5(b)]*. These amendments are discussed at 4 and 5 below.

FRS 101 does not permit use of the formats for the balance sheet and profit and loss account included in Part 1 'General Rules and Formats' of *The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008* (SI 2008/409) ('the Small Companies Regulations'). However, our view is that companies subject to the small companies regime can still apply FRS 101, and, in doing so, are not prevented from taking advantage of other Companies Act exemptions applicable to companies subject to the small companies regime. Likewise, medium-sized entities applying FRS 101 can still take advantage of applicable Companies Act disclosure exemptions for medium-sized entities. This chapter does not generally refer to the Small Companies and Small LLP Regulations.

While the discussion above refers to UK companies, there are similar requirements for LLPs (see 4.11 below).

2.1 Definition of a qualifying entity

FRS 101 defines a qualifying entity as 'a member of a group where the parent of that group prepares publicly available consolidated financial statements, which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation'. *[FRS 101 Appendix I]*.

A charity may not be a qualifying entity and therefore may not apply FRS 101. *[FRS 101 Appendix I]*.

There is no requirement that a qualifying entity is a member of the group in which it is consolidated for its entire reporting period. There is also no requirement that the financial statements of the qualifying entity and the consolidated financial statements of the parent of that group (which may be the reporting entity itself) must be coterminous or have reporting dates within a particular timeframe. The use of the present tense implies that the intention is only that the qualifying entity (where it does not prepare its own consolidated financial statements) is a subsidiary of the parent at its reporting date. This is consistent with UK company law which requires that an entity which is a parent at the end of a financial year must prepare group accounts unless it is exempted from the requirement. *[s399(2)]*.

The phrase 'included in the consolidation' is referenced to section 474(1) of the CA 2006 which states that this means that 'the undertaking is included in the accounts by the method of full (and not proportional) consolidation, and references to an undertaking excluded from consolidation shall be construed accordingly'. Therefore, entities that are not fully consolidated in the consolidated financial statements, such as subsidiaries of investment entities which are accounted for at fair value through profit or loss where required by IFRS 10 – *Consolidated Financial Statements*, cannot use FRS 101.

Associates and joint ventures are not qualifying entities since they are not members of a group (see 2.1.2 below).

There is no requirement for the consolidated financial statements in which the qualifying entity is included to be prepared under EU-adopted IFRS nor that the parent that prepares the consolidated financial statements is a UK entity. However, the consolidated financial statements must be intended to give a true and fair view (see 2.1.6 below).

2.1.1 Reporting date of the consolidated financial statements of the parent

The requirement for the qualifying entity to be included in the consolidation implies that the consolidated financial statements of the parent should be approved before, or at the same time as, the FRS 101 individual financial statements of the qualifying entity are approved. FRS 101 is silent on whether the reporting date and period of those consolidated financial statements has to be identical to that of the qualifying entity. In contrast, both sections 400 and 401 of the CA 2006 require that the exemption from preparing group accounts for a parent company that is a subsidiary undertaking is conditional on the inclusion of the company in the consolidated financial statements of a parent undertaking drawn up to the same date or to an earlier date in the same financial year. It would seem logical that the reporting date criteria in sections 400 and 401 should also be used for FRS 101.

However, when the consolidated financial statements are prepared as at an earlier date than the date of the qualifying entity's financial statements, some of the disclosure exemptions may not be available to the qualifying entity because the consolidated financial statements may not contain the 'equivalent' disclosures (see 6.2 below).

2.1.2 Definition of group and subsidiary

The definition of a qualifying entity contains a footnote that refers to section 474(1) of the CA 2006 which defines a 'group' as 'a parent undertaking and its subsidiary undertakings'. EU-adopted IFRS defines a group as 'a parent and its subsidiaries'. *[IFRS 10 Appendix A, s474(1)]*.

EU-adopted IFRS defines a parent as 'an entity that controls one or more entities' and a subsidiary as 'an entity that is controlled by another entity'. *[IFRS 10 Appendix A]*.

The CA 2006 states that an undertaking is a parent undertaking in relation to another undertaking, a subsidiary undertaking, if:

(a) it holds a majority of the voting rights in the undertaking; or

(b) it is a member of the undertaking and has the right to appoint or remove a majority of its board of directors; or

(c) it has the right to exercise a dominant influence over the undertaking by virtue of provisions in the undertaking's articles or by virtue of a control contract; or

(d) it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.

An undertaking should also be treated as a member for the purposes above if any of its subsidiary undertakings is a member of that undertaking or if any shares in that other undertaking are held by a person acting on behalf of the undertaking or any of its subsidiary undertakings.

An undertaking is also a parent undertaking in relation to another undertaking, a subsidiary undertaking, if it has the power to exercise, or actually exercises, dominant influence or control over it; or it and the subsidiary undertaking are managed on a unified basis.

A parent undertaking is treated as the parent undertaking of undertakings in relation to which any of its subsidiary undertakings are, or are to be treated as, parent undertakings; and references to its subsidiary undertakings should be construed accordingly. *[s1162(1)-(5)]*. Schedule 7 to the CA 2006 provides interpretation and references to 'shares' in section 1162 and in Schedule 7 are to 'allotted shares'. *[s1162(6)-(7)]*.

These differences in definition make it possible for an entity to be a subsidiary undertaking under the CA 2006 but not under EU-adopted IFRS, for example an entity in which a parent owns a majority of the voting rights but does not have control over the subsidiary (as defined in EU-adopted IFRS). However, the key issue for the application of FRS 101 is whether the subsidiary is included in the consolidation of the parent's consolidated financial statements. A company that meets the definition of a subsidiary undertaking under the CA 2006 but is not included in the consolidation of the consolidated financial statements of its parent cannot apply FRS 101.

2.1.3 Publicly available consolidated financial statements

By 'publicly available', we believe that FRS 101 requires that the consolidated financial statements can be accessed by the public as the use of the disclosure exemptions set out in the standard is conditional on a disclosure by the qualifying entity indicating from where those consolidated financial statements can be obtained (see 2.2 below). This does not mandate that the consolidated financial statements must be filed with a regulator. Therefore, for example, consolidated financial statements of a UK company that have not been filed with the Registrar of Companies, at the date the subsidiary's FRS 101 financial statements are approved, must be publicly available via some other medium.

2.1.4 Non-UK qualifying entities

There is no requirement that a qualifying entity is a UK entity. Non-UK entities can apply FRS 101 in their individual or separate financial statements subject to meeting the criteria for the use of the standard (see 2.2 below) and provided FRS 101 is allowed for use in their own jurisdiction.

2.1.5 Non-controlling interests

There is no ownership threshold for a subsidiary to apply FRS 101. Therefore, a qualifying entity can apply FRS 101 even if its parent holds less than a majority of the voting rights.

As a result of amendments made in December 2016 (see 1.2.1 above), there is no requirement for a qualifying entity to notify its shareholders about the proposed use of the disclosure exemptions and the ability of minority shareholders holding a specified proportion of the voting rights to object to the disclosure exemptions has also been removed. The requirement to notify shareholders was removed because the FRC considered that it was no longer cost-effective in practice and sufficient information would continue to exist for minority shareholders to understand the effects of the reduced disclosure framework. *[FRS 101.BC27]*. The FRC further considered that it was unnecessary to retain the right to object for shareholders holding a specified proportion of the voting rights given the information available to shareholders and their existing rights. *[FRS 101.BC28]*.

2.1.6 Intended to give a true and fair view

In the definition of a qualifying entity (see 2.1 above), the consolidated financial statements in which the qualifying entity is included are not required to give an explicit true and fair view of the assets, liabilities, financial position and profit or loss. Rather, they are '*intended* to give a true and fair view' (our emphasis). This means that the consolidated financial statements in which the qualifying entity is consolidated need not contain an explicit opinion that they give a 'true and fair view' but, in substance, they should be intended to give such a view. The FRC guidance – *True and Fair* – issued in June 2014 states that 'Fair presentation under IFRS is equivalent to a true and fair view'.[1]

A UK parent company that wishes to claim an exemption from preparing group accounts under either section 400 or section 401 of the CA 2006 must be a subsidiary included in the consolidated accounts for a larger group. Those consolidated accounts (and where appropriate, the group's annual report) must be drawn up: *[s400(2)(b), s401(2)(b)]*

- in accordance with the provisions of Directive 2013/34/EU ('the Accounting Directive') (for sections 400 and 401); or
- in a manner equivalent to consolidated accounts and consolidated reports so drawn up (for section 401); or
- in accordance with international accounting standards adopted pursuant to the IAS Regulation, i.e. EU-adopted IFRS (for sections 400 and 401); or
- in accordance with accounting standards which are equivalent to such international accounting standards, as determined pursuant to Commission Regulation (EC) No. 1569/2007 (for section 401).

There are similar requirements for a parent LLP but for section 401, there is no reference to the basis on which the consolidated reports are drawn up. *[s400(2)(b) (LLP), s401(2)(b) (LLP)]*. We believe that references to 'in accordance with the Accounting Directive', in relation to a banking or insurance group in sections 400 and 401, mean as modified by the provisions of the Bank Accounts Directive or the Insurance Accounts Directive respectively. *[s400(2)(b), s401(2)(b), s400(2)(b) (LLP), s401(2)(b) (LLP)]*.

In our view, a set of consolidated financial statements that would meet the above criteria (i.e. the consolidated financial statements are drawn up in accordance with or in a manner equivalent to the Accounting Directive, or in accordance with EU-adopted IFRS or accounting standards which are equivalent to EU-adopted IFRS as determined by the mechanism established by the EU Commission) is intended to give a true and fair view.

The Application Guidance to FRS 100 – *Application of Financial Reporting Requirements* – states that consolidated financial statements of a higher parent will meet the test of equivalence in the Accounting Directive if they are intended to give a true and fair view and:

- are prepared in accordance with FRS 102;
- are prepared in accordance with EU-adopted IFRS;
- are prepared in accordance with IFRS, subject to the consideration of the reasons for any failure by the European Commission to adopt a standard or interpretation; or
- are prepared using other GAAPs which are closely related to IFRS, subject to the consideration of the effect of any differences from EU-adopted IFRS.

Consolidated financial statements of the higher parent prepared using other GAAPs or the IFRS for SMEs should be assessed for equivalence with the Accounting Directive based on the particular facts, including the similarities to and differences from the Accounting Directive. *[FRS 100.AG6]*.

In accordance with Commission Regulation (EC) No. 1569/2007 of 21 December 2007 (see above), the EU Commission has identified the following GAAPs as equivalent to international accounting standards. This means that these GAAPs are equivalent to international accounting standards as a matter of UK law: *[FRS 100.AG7]*

Equivalent GAAP	*Applicable from*
GAAP of Japan	1 January 2009
GAAP of the United States of America	I January 2009
GAAP of the People's Republic of China	1 January 2012
GAAP of Canada	1 January 2012
GAAP of the Republic of Korea	1 January 2012

In addition, third country issuers were permitted to prepare their annual consolidated financial statements and half-yearly consolidated financial statements in accordance with the GAAP of the Republic of India for financial years starting before 1 April 2016. For reporting periods beginning on or after 1 April 2016, in relation to GAAP of the Republic of India, equivalence should be assessed on the basis of the particular facts.

The concept of equivalence for the purposes of section 401 is discussed further in Chapter 8 at 3.1.1.C.

In theory, there is no reason why consolidated financial statements of a parent prepared under a GAAP that is not 'equivalent' to the Accounting Directive cannot be used provided those consolidated financial statements in which the entity is included are publicly available and are intended to give a true and fair view.

In addition, as set out above, a number of the disclosure exemptions from EU-adopted IFRS in FRS 101 are conditional on 'equivalent' disclosures being made in those consolidated financial statements in which the qualifying entity is included. Where the equivalent disclosure is not made, the relevant disclosure exemptions cannot be applied in the qualifying entity's financial statements prepared under

FRS 101 (see 6.2 below). A GAAP that is not 'equivalent' to the Accounting Directive is less likely to have those 'equivalent' disclosures.

One issue not addressed by FRS 101 is the impact of a qualified audit opinion on the parent's consolidated financial statements on a qualifying entity's ability to use FRS 101. A Queen's Counsel's opinion obtained by the FRC in 2008 stated that 'the scope for arguing that financial statements which do not comply with relevant accounting standards nevertheless give a true and fair view, or a fair presentation, is very limited'.[2]

2.2 Use of the disclosure exemptions

The use of the disclosure exemptions in FRS 101 (see 6 below) is conditional on all of the following criteria being met: *[FRS 101.5]*

- the reporting entity applies, as its financial reporting framework, the recognition, measurement and disclosure requirements of EU-adopted IFRS but makes those amendments to EU-adopted IFRS as required by the Application Guidance to FRS 101 that are necessary in order to comply with the CA 2006 and the Regulations. This is because financial statements prepared under FRS 101 are Companies Act individual accounts as defined in section 395(1) of the CA 2006 but the Application Guidance applies to any qualifying entity applying FRS 101, including those that are not companies (see 4 and 5 below);
- the reporting entity discloses in the notes to its financial statements a brief narrative summary of the disclosure exemptions adopted; and
- the reporting entity discloses the name of the parent of the group in whose consolidated financial statements its financial statements are consolidated (i.e. the parent identified in the definition of a 'qualifying entity') and from where those financial statements may be obtained.

A qualifying entity which is a financial institution is entitled to more limited disclosure exemptions (see 6.4 below).

2.3 The impact of section 400 and section 401 of the CA 2006 on FRS 101

FRS 101 does not override either section 400 or section 401 of the CA 2006. Section 400 exempts a UK parent company from preparing consolidated accounts if it is a subsidiary undertaking (whose immediate parent undertaking is established under the law of an EEA State) and is included in the consolidated accounts of a larger group drawn up to the same date, or to an earlier date in the same financial year, by a parent undertaking established under the law of an EEA State. Section 401 exempts a UK parent company from preparing consolidated accounts if it is a subsidiary undertaking of a parent undertaking *not* established under the law of an EEA State and the company and all of its subsidiary undertakings are included in the consolidated accounts of a larger group drawn up to the same date, or to an earlier date in the same financial year, by a parent undertaking. The exemptions from preparing consolidated accounts in both sections 400 and 401 are subject to various conditions including 'equivalence' (in respect of section 401, which is discussed at 2.1.6 above). The detailed conditions for the above exemptions from preparing group accounts under the CA 2006 are discussed further in Chapter 8 at 3.1.1.

If a UK parent company does not meet all of the conditions set out in either section 400 or section 401 (and is not otherwise exempt under the CA 2006) then it must prepare consolidated financial statements. Such consolidated financial statements cannot be prepared under FRS 101. However, the parent entity could still prepare its individual financial statements under FRS 101.

At the time of writing this chapter, the company law requirements of sections 400-401 have not been altered as a result of Brexit. However, the government has published draft legislative proposals – *The Accounts and Reports (Amendment) (EU Exit) Regulations 2018*. See Chapter 8 at 3.1.1.G for discussion of these draft proposals.

2.4 Interim financial statements

FRS 101 does not address the preparation of interim financial statements. However, entities applying FRS 101 to annual financial statements may use FRS 104 – *Interim Financial Reporting* – as a basis for their interim financial reports. FRS 104 is discussed in Chapter 34.

3 TRANSITION TO FRS 101

An entity can transition to FRS 101 from either EU-adopted IFRS or another form of GAAP (e.g. another form of UK GAAP). In this context, another form of UK GAAP currently means either FRS 102 or FRS 105 – *The Financial Reporting Standard applicable to the Micro-entities Regime*.

FRS 101 is adopted in the first accounting period for which a reporting entity makes a statement of compliance with the standard (see 1.3 above). The date of transition is the beginning of the earliest period for which an entity presents full comparative information under a given standard in its first financial statements that comply with that standard. *[FRS 100 Appendix I]*. For example, the date of transition is 1 January 2018 for an entity with a 31 December year-end adopting FRS 101 for the first time in its 2019 financial statements. *[FRS 100 Appendix I]*.

3.1 Companies Act restrictions on changes to FRS 101

Under the CA 2006, a company that wishes to change from preparing IAS individual accounts to preparing individual accounts under FRS 101 may do so either:

- if there is a 'relevant change of circumstance' as defined in section 395(4) of the CA 2006; or
- for financial years ending on or after 1 October 2012, for a reason other than a relevant change of circumstance, once in a five year period. *[FRS 100 Appendix II.14]*.

There is no restriction on the number of times an entity can move from Companies Act accounts to IAS accounts or *vice versa*. Theoretically, an entity could 'flip' from IAS accounts to FRS 101 and back again several times without a 'relevant change in circumstance' provided such flips are done no more than once every five years and provided that the entity is also complying with the requirements of the CA 2006 such as those relating to consistency of financial reporting within groups (see 3.2 below).

There are no Companies Act restrictions on a change from FRS 102 or FRS 105 to FRS 101 and back again or *vice versa* since these are all Companies Act accounts.

3.2 Consistency of financial statements within the group

The CA 2006 requires that the directors of a UK parent company secure that the individual accounts of the parent company and of each of its subsidiary undertakings are prepared under the same financial reporting framework, be it IAS accounts or Companies Act accounts, except to the extent that in the directors' opinion there are good reasons for not doing so. *[s407(1)]*. However, this rule does not apply:

- if the parent company does not prepare group accounts; *[s407(2)]*
- if the accounts of the subsidiary undertaking are not required to be prepared under Part 15 of the CA 2006 (for example, foreign subsidiary undertakings); *[s407(3)]* or
- to any subsidiary undertakings that are charities (charities and non-charities within a group are not required to use the same accounting framework). *[s407(4)]*. This is because charities are not permitted to prepare either IAS group or individual accounts. *[s395(2), s403(3)]*.

Additionally, a UK parent company that prepares both consolidated and separate financial statements under EU-adopted IFRS (i.e. IAS group accounts and IAS individual accounts) is not required to ensure that its subsidiary undertakings all prepare IAS individual accounts. However, it must ensure that each of its subsidiary undertakings use the same accounting framework in their individual accounts unless there are good reasons for not doing so. *[s407(5)]*.

Therefore, a group that decides to use FRS 101 for any of its UK subsidiary undertakings, must ensure, unless there are good reasons for not doing so, that all its UK subsidiary undertakings prepare Companies Act individual accounts (i.e. the same financial reporting framework). This requirement only applies to subsidiary undertakings in scope of the section 407 consistency requirements.

Although not explicitly stated by FRS 100, there appears to be no requirement that all UK subsidiary undertakings in a group must use FRS 101 for their Companies Act individual accounts. Some subsidiary undertakings could also use FRS 102, since these are all Companies Act individual accounts and therefore they are all under the same financial reporting framework. However, while this approach would comply with the statutory requirements, groups that use a 'mix' of GAAP in the individual financial statements may be challenged by HMRC, particularly if this results in tax arbitrage.

Examples of 'good reasons' for not preparing all individual accounts within a group using the same reporting framework are contained in the document *Guidance for UK Companies on Accounting and Reporting: Requirements under the Companies Act 2006 and the application of the IAS Regulation* issued by the Department for Business Enterprise and Regulatory Reform (BERR) in June 2008.

3.3 Transition from EU-adopted IFRS to FRS 101

In substance, the transition requirements for entities that have been applying EU-adopted IFRS prior to conversion to FRS 101 treat the qualifying entity as not having changed its financial reporting framework. Disclosure is required only where changes are made on transition. *[FRS 100.12, FRS 101.7A]*. FRS 101 modifies EU-adopted IFRS in certain respects, in order to comply with the Companies Act and the Regulations.

A qualifying entity that is applying EU-adopted IFRS prior to the date of transition to FRS 101 will then be preparing Companies Act individual accounts in accordance with s395(1)(a) of the CA 2006 (rather than IAS individual accounts in accordance with s395(1)(b) of the CA 2006). It therefore must consider whether amendments are required to comply with paragraph 5(b) of FRS 101 – see 4 and 5 below – but it does not reapply the provisions of IFRS 1. Where amendments in accordance with paragraph 5(b) of FRS 101 are required, the entity should determine whether the amendments have a material effect on the first FRS 101 financial statements presented. *[FRS 100.12]*. Details of measurement differences between EU-adopted IFRS and FRS 101 which might result in a material effect on the financial statements are discussed at 4 below.

Where there is no material effect of such changes, the qualifying entity should disclose that it has undergone transition to FRS 101 and give a brief narrative of the disclosure exemptions taken for all periods presented in the financial statements. *[FRS 100.12(a)]*.

Where there is a material effect caused by such changes, the qualifying entity's first FRS 101 financial statements should include: *[FRS 100.12(b)]*

- a description of the nature of each material change in accounting policy;
- reconciliations of its equity determined in accordance with EU-adopted IFRS to its equity determined in accordance with FRS 101 for both the date of transition to FRS 101 and for the end of the latest period presented in the entity's most recent annual financial statements prepared in accordance with EU-adopted IFRS; and
- a reconciliation of the profit or loss determined in accordance with EU-adopted IFRS to its profit or loss determined in accordance with FRS 101 for the latest period presented in the entity's most recent annual financial statements prepared in accordance with EU-adopted IFRS.

This means that, for an entity adopting FRS 101 for the first time in its annual financial statements ending on 31 December 2019 (and presenting one comparative period), reconciliations will be required of:

- equity as at 1 January 2018 and 31 December 2018; and
- profit or loss for the year ended 31 December 2018.

There is no requirement for a transition balance sheet to be prepared. *[FRS 100.12, FRS 101.7A]*.

Amendments with a material effect must be applied retrospectively on transition unless impracticable. When it is impracticable to apply the amendments retrospectively, the qualifying entity should apply the amendment to the earliest period for which it is practicable to do so and it should identify the data presented for prior periods that are not comparable with the data for the period in which it prepares its first financial statements that conform to FRS 101. *[FRS 100.13]*. 'Impracticable' is defined in IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors*.

Paragraph 5(b) of FRS 101 cross-refers to Application Guidance 1 to the standard (which forms an integral part of the standard) that includes presentational as well as recognition and measurement modifications to EU-adopted IFRS required when applying the standard. The transitional rules contain no explicit requirement to disclose material presentational changes such as the use of balance sheet and profit and loss formats in accordance with the Regulations (especially where statutory rather than adapted formats are used). However, we recommend that entities explain any material presentational changes compared to EU-adopted IFRS arising from adoption of FRS 101 in order to assist readers' understanding of the financial statements.

3.4 Transition from another version of UK GAAP or another GAAP to FRS 101

In substance, the transition requirements treat conversion to FRS 101 from another version of UK GAAP (currently FRS 102 or FRS 105) or another GAAP as a full first time conversion to EU-adopted IFRS (as modified by FRS 101).

A qualifying entity that transitions to FRS 101 should, unless it is applying EU-adopted IFRS prior to the date of transition (see 3.3 above), apply the requirements of paragraphs 6 to 33 of IFRS 1 (as adopted by the EU) including the relevant appendices, except for the requirement of paragraphs 6 and 21 to present an opening statement of financial position at the date of transition. References to IFRSs in IFRS 1 are interpreted to mean EU-adopted IFRS as amended in accordance with paragraph 5(b) of FRS 101. *[FRS 100.11(b)]*. This means that all of the recognition, measurement and disclosure rules for an IFRS first-time adopter apply (except for the requirement to present an opening statement of financial position) to the extent they do not conflict with EU-adopted IFRS as amended by paragraph 5(b) of FRS 101. First-time adoption of IFRS is discussed in Chapter 5 of EY International GAAP 2019.

IFRS 1 sets out specific requirements for where a subsidiary becomes a first-time adopter later than its parent ('the D16 election'). or where a parent becomes a first-time adopter later than its subsidiary or a parent becomes a first-time adopter in its separate financial statements earlier or later than in its consolidated financial statements ('the D17 requirements'). *[IFRS 1.Appendix D.16-17]*. These requirements are both amended by FRS 101 as described at 3.4.1 and 3.4.2 below.

3.4.1 The D16 election

FRS 101 amends the D16 election to: *[FRS 101.AG1(a)]*

- remove the sentence stating that the election to use the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's transition to IFRSs, is not available to a subsidiary of an investment entity that is required to be measured at fair value through profit or loss; and
- add a sentence stating that 'A qualifying entity that applies this provision must ensure that its assets and liabilities are measured in accordance with company law'.

The purpose of the second amendment is to restrict the application of the D16 election to situations where the measurement of assets and liabilities in the subsidiary's or parent's individual financial statements based on consolidated financial statements would comply with company law. FRS 101 financial statements must comply with the measurement requirements of the CA 2006 which may be inconsistent with those of EU-adopted IFRS applied in the consolidated financial statements. *[FRS 101 Appendix II.Table 1]*. The sentence was amended by the Triennial review 2017.

Previously, it stated that 'A qualifying entity that applies this provision must ensure that its assets and liabilities are measured in compliance with FRS 101.'

The FRC does not explain the first amendment although an entity which is not consolidated by its parent cannot apply FRS 101 (see 2.1 above).

3.4.2 The D17 requirements

FRS 101 amends the D17 requirements by adding a sentence stating that 'A qualifying entity that applies this provision must ensure that its assets and liabilities are measured in accordance with company law'. *[FRS 101.AG1(b)].*

This amendment (which was made by the Triennial review 2017 in the same way as for the D16 election) has the same purpose as described at 3.4.1 above. *[FRS 101 Appendix II.Table 1].*

FRS 101 also amends the D17 requirements to remove the sentence 'Notwithstanding this requirement, a non-investment entity parent shall not apply the exception to consolidation that is used by any investment entity subsidiaries'. However, this sentence is not relevant to FRS 101 financial statements, which are not consolidated financial statements.

3.5 The impact of transition on realised profits

There may be circumstances where a conversion to FRS 101 eliminates a qualifying entity's realised profits or turns those realised profits into a realised loss. TECH 02/17BL – *Guidance on Realised and Distributable Profits under the Companies Act 2006* – issued by the ICAEW and ICAS, (TECH 02/17BL) states that the change in the treatment of a retained profit or loss as realised (or unrealised) as a result of a change in the law or in accounting standards or interpretations would not render unlawful a distribution already made out of realised profits determined by reference to 'relevant accounts' which had been prepared in accordance with generally acceptable accounting principles applicable to those accounts. This is because the CA 2006 defines realised profits or losses for determining the lawfulness of a distribution as 'such profits and losses of the company as fall to be treated as realised in accordance with principles generally accepted at the time when the accounts are prepared, with respect to the determination for accounting purposes of realised profits or losses'. *[TECH 02/17BL.3.28-29].*

The effects of the introduction of a new accounting standard or of the adoption of IFRS become relevant to the application of the common law capital maintenance rule only in relation to distributions accounted for in periods in which the change will first be recognised in the accounts. This means that a change in accounting policy known to be adopted in a financial year needs to be taken into account in determining the dividend to be approved by shareholders in that year. Therefore, for example, an entity converting to FRS 101 in 2019 must have regard to the effect of adoption of FRS 101 in respect of all dividends payable in 2019 (including any final dividends in respect of 2018) even though the 'relevant accounts' may still be those for 2018 prepared under another GAAP. *[TECH 02/17BL.3.30-37].*

Statutory 'interim accounts' are required to be prepared under sections 836(2) and 838 of the CA 2006 (and delivered to the Registrar if the company is a public company) if a proposed distribution cannot be justified by reference to the relevant accounts. See Chapter 1 at 5.5 for further discussion.

4 MEASUREMENT DIFFERENCES BETWEEN FRS 101 AND EU-ADOPTED IFRS

As noted at 2 above, entities applying FRS 101 use EU-adopted IFRS as amended by the standard in order to comply with the CA 2006 and the Regulations. This is because financial statements prepared under FRS 101 are Companies Act individual accounts and not IAS individual accounts. There are several conflicts between the recognition and measurement rules of EU-adopted IFRS and those required by the Regulations. Consequently, entities applying FRS 101 apply a modified version of EU-adopted IFRS designed to eliminate these differences.

FRS 101 does not modify EU-adopted IFRS in respect of goodwill and indefinite-life intangible assets. However, non-amortisation of those assets conflicts with the Regulations necessitating use of a 'true and fair override' as explained at 4.1 below.

Similarly, FRS 101 does not modify IFRS 9's requirement to present changes in the fair value of a financial liability attributable to own credit risk in other comprehensive income. However, this presentation conflicts with the Regulations necessitating use of a 'true and fair override' as explained at 4.2 below.

In respect of the matters discussed at 4.3 to 4.11 below, FRS 101 specifically amends EU-adopted IFRS to remove conflicts identified between EU-adopted IFRS and the Regulations. Therefore, the issue of invoking a 'true and fair override' does not arise in respect of these other matters.

FRS 101 changes EU-adopted IFRS in respect of the following matters:

- negative goodwill (see 4.3 below);
- contingent consideration balances arising from business combinations (see 4.4 below);
- government grants deducted from the cost of fixed assets (see 4.5 below);
- provisions, contingent assets and contingent liabilities (see 4.6 below);
- realised profits (see 4.7 below);
- equalisation provisions (see 4.8 below);
- investments in subsidiaries, associates and joint ventures by banking and insurance entities (see 4.9 below); and
- investment entities (see 4.10 below).

The position as regards limited liability partnerships (LLPs) is discussed at 4.11 below.

4.1 Positive goodwill and indefinite-life intangible assets

No changes have been made to EU-adopted IFRS in respect of positive goodwill that is not amortised. Instead, FRS 101 states that paragraph B63(a) of IFRS 3 – *Business Combinations*, which requires that goodwill is measured at cost less impairment, should be read in accordance with paragraph A2.8 of FRS 101. *[FRS 101.AG1(f)]*. The non-amortisation of goodwill required by IFRS 3 conflicts with paragraph 22 of Schedule 1 to the Regulations (and its equivalents in Schedules 2 and 3) which require that an intangible asset (including goodwill) must be written off over its useful economic life.

FRS 101 notes that the non-amortisation of goodwill will usually be a departure, for the overriding purpose of giving a true and fair view, from the requirements of the Regulations.

FRS 101 goes on to state that this is not a new instance of the use of the 'true and fair override' and it would have been required for companies reporting under previous UK GAAP which used an indefinite life for goodwill as permitted by FRS 10 – *Goodwill and intangible assets*. *[FRS 101 Appendix II.8, 1 Sch 22]*.

This means that the FRC expects that entities with positive goodwill should not amortise that goodwill under FRS 101. Those entities should invoke a true and fair override as permitted by paragraph 10(2) of Schedule 1 to the Regulations (or its equivalents in Schedules 2 and 3) to overcome the requirement to write off goodwill over its useful economic life in paragraph 22 of Schedule 1 to the Regulations (or its equivalents in Schedules 2 and 3). The use of the true and fair override requires disclosure of the particulars of the departure from the Regulations, the reasons for it and its effect. *[FRS 101 Appendix II.8, 1 Sch 10(2)]*. Continuation of goodwill amortisation, if permitted under previous GAAP, is not allowed by FRS 101.

It is anticipated that the use of a true and fair override in respect of goodwill amortisation will be limited in application since, in individual financial statements, there will only be goodwill where a business that is not an entity has been acquired.

FRS 101 goes on to state that similar considerations (i.e. the need for a true and fair override) may apply to other intangible assets that are not amortised because they have an indefinite life and intangible assets that have a residual value that is not zero (i.e. intangible assets that are not written off over their useful economic life). *[FRS 101 Appendix II.8A, 1 Sch 22]*.

4.2 Presentation of fair value gains and losses attributable to changes in own credit risk on financial liabilities designated at fair value through profit or loss in other comprehensive income

IFRS 9 requires qualifying entities to present fair value gains or losses attributable to changes in own credit risk on financial liabilities designated at fair value through profit or loss in other comprehensive income. The Note on Legal Requirements to FRS 101 observes that this will usually be a departure from the requirement of paragraph 40 of Schedule 1 of the Regulations (and its equivalents in Schedules 2 and 3) for the overriding purpose of giving a true and fair view. As a result, when applicable, disclosure will need to be given in the notes to the accounts of 'particulars of the departure, the reasons for it and its effect'. *[FRS 101 Appendix II.7F]*.

FRS 101 is silent about the other two circumstances in IFRS 9 in which accounting for fair value gains and losses are required in other comprehensive income. In our view:

- accounting for changes in the fair value of an equity instrument through other comprehensive income (without recycling of fair value changes to profit and loss) makes use of the alternative accounting rules in the Regulations and does not therefore require the use of a true and fair override (see Chapter 6 at 10.2); and
- the model used for accounting for changes in the fair value of a debt instrument through other comprehensive income is similar, but not identical, to the available-for-sale asset model under IAS 39 – *Financial Instruments: Recognition and Measurement*. In our view, it is inferred from FRS 101's silence on the matter that this model is included within the fair value accounting rules in the Regulations (see Chapter 6 at 10.3) and does not therefore require the use of a true and fair override to apply.

4.3 Negative goodwill

FRS 101 changes paragraph 34 of IFRS 3 so that any gain arising from a bargain purchase (i.e. negative goodwill) is not recognised immediately in profit and loss. Instead, any amount of negative goodwill resulting from a business combination should be shown on the face of the statement of financial position on the acquisition date, immediately below goodwill, and followed by a subtotal of the net amount of positive and negative goodwill. Subsequently, the negative goodwill up to the fair value of the non-monetary assets acquired should be recognised in profit and loss in the periods in which the non-monetary assets are recovered. Any amount of the negative goodwill in excess of the fair values of the non-monetary assets acquired should be recognised in profit or loss in the periods expected to be benefited. *[FRS 101.AG1(c)]*.

This change to EU-adopted IFRS was necessary because the Accounting Directive (on which the requirements in the Regulations are based) may be inconsistent with the recognition requirements for negative goodwill under EU-adopted IFRS. *[FRS 101 Appendix II Table 1]*.

Monetary assets are defined in EU-adopted IFRS as 'money held and assets to be received in fixed or determinable amounts of money'. *[IAS 38.8]*. Conversely, an essential feature of a non-monetary asset is the absence of a right to receive a fixed or determinable number of units of currency. IAS 21 – *The Effects of Changes in Foreign Exchange Rates* – gives examples of non-monetary assets as amounts prepaid for goods and services, goodwill, intangible assets, inventories and property, plant and equipment. *[IAS 21.16]*. IFRS 9 states that investments in equity instruments are non-monetary items. *[IFRS 9.B5.7.3]*. This suggests that equity investments in subsidiaries, associates or joint ventures are also non-monetary items.

4.4 Contingent consideration balances arising from business combinations

Contingent consideration balances arising from business combinations whose acquisition dates are on or after the date an entity first applied the amendments to company law, set out in *The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015* (SI 2015/980), i.e. generally the start of accounting periods beginning on or after 1 January 2016 when SI 2015/980 was not early adopted, should be accounted for in accordance with IFRS 3. *[FRS 101.AG1(d)]*. This means that contingent consideration is initially recognised at fair value with subsequent changes in the fair value of contingent consideration not classified as equity recognised in profit or loss. *[IFRS 3.58]*.

Contingent consideration balances arising from business combinations whose acquisition dates preceded the date when an entity first applied the amendments to company law set out in SI 2015/980 should not be adjusted as a result of the change in company law. Instead, the entity's previous accounting policies for contingent consideration should continue to apply. *[FRS 101.AG1(d)]*. Prior to the July 2015 amendments which incorporate SI 2015/980, FRS 101 required that an adjustment to the cost of a business combination contingent on future events be recognised only if the estimated amount of the adjustment was probable and could be measured reliably. If the potential adjustment was not recognised at the acquisition date but subsequently became probable and could be measured reliably, the additional consideration was treated as an adjustment to the cost of the combination (i.e. goodwill).

FRS 101 is silent on accounting for contingent consideration on the acquisition of a subsidiary, associate or joint venture which is accounted for as an investment under IAS 27. However, in practice, if contingent consideration is included in the initial measurement of the asset, subsequent payments are either recognised in profit or loss or capitalised as part of the cost of the asset. We believe that, consistent with the view expressed in Chapter 8 at 2.1.1 of EY International GAAP 2019, until the IASB issues further guidance, differing views remain about the circumstances in which, and to what extent, variable payments, such as contingent consideration should be recognised when initially recognising the underlying asset. There are also differing views about the extent to which subsequent changes should be recognised through profit or loss or capitalised as part of the cost of the asset. Where entities have made an accounting policy choice regarding recognition of contingent consideration and subsequent changes in accounting for the cost of investments in subsidiaries, associates or joint ventures in separate financial statements, the policy should be disclosed and consistently applied.

4.5 Government grants deducted from the cost of fixed assets

FRS 101 has deleted paragraph 28 of IAS 16 – *Property, Plant and Equipment* – and has amended or deleted paragraphs 24 to 29 of IAS 20 – *Accounting for Government Grants and Disclosure of Government Assistance* – in order to eliminate the option in IFRS that permits a government grant relating to an asset to be deducted in arriving at the carrying amount of the asset. Consequently, all government grants related to assets should be presented in the financial statements by setting up the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset. In addition, the option in paragraph 29 of IAS 20 that permits grants related to income to be deducted in reporting the related expense has been deleted. Consequently, in profit or loss the grant must be reported either separately or under a general heading such as 'Other operating income'. *[FRS 101.AG1(l)-(r)]*.

These changes to EU-adopted IFRS were necessary because the Regulations prohibit off-setting of items that represent assets against items that represent liabilities unless specifically permitted or required. *[FRS 101 Appendix II Table 1]*.

4.6 Provisions, contingent assets and contingent liabilities

FRS 101 changes paragraph 92 of IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* – to state that when, in extremely rare cases, disclosure of some or all of the information required by paragraphs 84-89 of IAS 37 can be expected to prejudice seriously the position of the entity in a dispute with other parties, on the subject matter of the provision, contingent liability or contingent asset, the entity need not disclose all of the information required by those paragraphs insofar as it relates to the dispute, but should disclose at least the following: *[FRS 101.AG1(s)]*

- in relation to provisions:
  - a table showing the reconciliation required by paragraph 84 in aggregate, including the source and application of any amounts transferred to or from provisions during the reporting period;
  - particulars of each provision in any case where the amount of the provision is material; and
  - the fact that, and reason why, the information required by paragraphs 84 and 85 has not been disclosed.
- in relation to contingent liabilities:
  - particulars and the total amount of any contingent liabilities (excluding those which arise out of insurance contracts) that are not included in the statement of financial position;
  - the total amount of contingent liabilities which are undertaken on behalf of or for the benefit of:
    - any parent or fellow subsidiary of the entity;
    - any subsidiary of the entity; or
    - any entity in which the reporting entity has a participating interest,

    should each be stated separately; and
  - the fact that, and reason why, the information required by paragraph 86 has not been disclosed.
- In relation to contingent assets, the entity should disclose the general nature of the dispute, together with the fact that, and reason why, the information required by paragraph 89 has not been disclosed.

This amendment was made because the 'seriously prejudicial' exemption in IAS 37 does not apply to disclosures required by the Regulations. Although this matter is implicitly covered by paragraph 4A of FRS 101, which requires that the requirements of the Regulations must be complied with (see 2 above), the FRC decided to specifically highlight this constraint on the IAS 37 exemption. *[FRS 101.BC79]*.

These amended disclosures apply to all entities applying FRS 101, not just entities subject to the requirements of the Regulations.

4.7 Realised profits

FRS 101 has changed paragraph 88 of IAS 1 to clarify the precedence of the Regulations over IFRS in this matter by adding the words 'or unless prohibited by the Act' after 'an entity should recognise all items of income and expense arising in a period in profit or loss unless an IFRS requires or permits otherwise'. *[FRS 101.AG1(k)]*.

Paragraph 13(a) of Schedule 1 to the Regulations (and its equivalents in Schedules 2 and 3 (the related requirement in Schedule 3 is modified)) require that only profits realised at the balance sheet date are included in the profit or loss account. *[FRS 101 Appendix II.12]*. Paragraph 39 of Schedule 1 to the Regulations (and its equivalents in Schedules 2 and 3) allow stocks, investment property and living animals or plants to be held at fair value in Companies Act accounts. *[FRS 101 Appendix II.13]*. Paragraph 40(2) of Schedule 1 to the

Regulations (and its equivalents in Schedules 2 and 3) require that, in general, movements in the fair value of financial instruments, stocks, investment properties or living animals and plants are recognised in the profit and loss account notwithstanding the usual restrictions allowing only realised profits and losses to be included in the profit and loss account. Therefore, paragraph 40 of Schedule 1 overrides paragraph 13(a) of Schedule 1 and such fair value gains can be recognised in profit and loss under FRS 101. *[FRS 101 Appendix II.14]*.

The legal appendix to FRS 101 states that entities measuring investment properties, living animals or plants, or financial instruments at fair value may transfer such amounts to a separate non-distributable reserve instead of carrying them forward in retained earnings but are not required to do so. The FRC suggests that presenting fair value movements that are not distributable profits in a separate reserve may assist with the identification of profits available for that purpose. *[FRS 101 Appendix II.15]*.

Whether profits are available for distribution must be determined in accordance with applicable law. Entities may also refer to TECH 02/17BL to determine the profits available for distribution. *[FRS 101 Appendix II.16]*.

4.8 Equalisation provisions

FRS 101 has changed paragraph 14(a) of IFRS 4 – *Insurance Contracts* – to insert the words 'unless otherwise required by the regulatory framework that applies to the entity' at the beginning of the sentence which prohibits the recognition of catastrophe provisions and equalisation provisions. In addition, the following sentence has been added to the end of the paragraph. 'The presentation of any such liabilities should follow the requirements of the Regulations (or other legal framework that applies to that entity).' *[FRS 101.AG1(fA)]*.

The purpose of these amendments was to remove a conflict between IFRS 4 (which does not permit the recognition of equalisation and catastrophe provisions for claims that have not been incurred) and Schedule 3 to the Regulations (which requires the recognition of equalisation provisions as a liability).

However, following the implementation of the Solvency II regulatory regime, with effect from 1 January 2016, the UK regulatory framework no longer allows insurers to recognise catastrophe provisions and equalisation provisions (although Schedule 3 to the Regulations was not amended). However, insurers may recognise equalisation or catastrophe provisions if permitted under another legal framework.

4.9 Equity accounting for investments in subsidiaries, associates and joint ventures

IAS 27, Schedule 1 to the Regulations and the LLP Regulations permit the use of equity accounting for investments in subsidiaries, associates and joint ventures.

The use of equity accounting for these interests is conditional on the investment in subsidiary, associate or joint venture qualifying as a participating interest (see Chapter 6 at 5.3.4.D), which will usually be the case. If participating interests are accounted for using the equity method and the profit attributable to a participating interest recognised in profit and loss account exceeds the amount of any dividends (including dividends already paid and those whose payment can be claimed), the difference must be placed in a reserve which cannot be distributed to shareholders. *[1 Sch 29A(2)(b)]*.

However, Schedule 2 and Schedule 3 to the Regulations do not permit the use of equity accounting for participating interests. Therefore, entities applying either Schedule 2 or Schedule 3 to the Regulations (i.e. banking and insurance entities, respectively) may not take advantage of the option in paragraph 10(c) of IAS 27 to account for investments in subsidiaries, joint ventures and associates using the equity method. *[FRS 101 Appendix II.7E]*.

4.10 Investment entities

FRS 101 does not apply to consolidated financial statements. However, a parent that meets the definition of an investment entity under IFRS 10, and is therefore required (in most situations) to measure its investment in a subsidiary at fair value through profit or loss, must measure that investment in the same way in its separate financial statements, as required by paragraph 11A of IAS 27. In other words, a qualifying entity that meets the definition of an investment entity must measure its investment in subsidiaries at fair value through profit or loss in its individual financial statements. *[FRS 101 Appendix II.17]*.

An investment entity which measures its investments in subsidiaries at fair value through profit or loss will be required to make the additional disclosures required by paragraph 36(4) of Schedule 1 to the Regulations (see 6.3 below). *[FRS 101 Appendix II.20]*.

4.11 Limited liability partnerships (LLPs)

LLPs applying FRS 101 will be doing so in conjunction with *The Limited Liability Partnerships, (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (SI 2008/1911)* and the LLP Regulations, both as amended. It is considered by the FRC that in many cases these regulations are similar to the Regulations, limiting the situations in which legal matters relevant to the financial statements of LLPs are not addressed in Appendix II to FRS 101. *[FRS 101 Appendix II.21]*.

Therefore, generally, the issues identified in relation to Schedule 1 to the Regulations at 4.1 to 4.10 above also apply to Schedule 1 to the LLP Regulations.

5 PRESENTATIONAL DIFFERENCES BETWEEN FRS 101 AND EU-ADOPTED IFRS

As noted at 2 above, UK companies applying FRS 101 must prepare their financial statements in accordance with the CA 2006 and the Regulations. This is because financial statements prepared under FRS 101 are Companies Act accounts and not IAS accounts. *[FRS 101 Appendix II.3]*. The presentation requirements of the CA 2006 and the Regulations are discussed in Chapter 6. While, generally, this chapter refers to companies and the Regulations, the requirements for LLPs are similar, although there are some minor differences.

The following presentational matters are discussed below:

- balance sheet and profit and loss account formats required by FRS 101 (see 5.1 below);
- order of presentation of the notes to the financial statements (see 5.2 below);
- presentation of extraordinary activities (see 5.3 below); and
- presentation of discontinued operations (see 5.4 below).

The Regulations address the balance sheet and profit and loss account formats and the notes required in the statutory accounts of UK companies. Accordingly, the presentation amendments made in Application Guidance 1 to FRS 101 (which apply to all qualifying entities, not just UK companies) relate to the balance sheet and profit and loss section of the statement of comprehensive income (whether in one or two statements). IAS 1's requirements for presentation of other comprehensive income still apply. FRS 101 makes no amendments to the requirement in IAS 1 to present a statement of changes in equity for the reporting period.

There is no requirement to present a statement of cash flows when the reduced disclosure exemption is taken and use of the disclosure exemption is disclosed in the financial statements (see 6.1.10 below).

A UK parent company presenting both consolidated financial statements (either IAS group accounts or Companies Act group accounts) and individual financial statements under FRS 101 can take advantage of the exemption in section 408 of the CA 2006 from presenting a profit and loss account and related notes in respect of its individual profit and loss account. *[s408]*.

5.1 Balance sheet and profit and loss formats required by FRS 101

Qualifying entities subject to Schedule 1 to the Regulations have a choice regarding the presentation of the balance sheet and the profit and loss account. These entities can either:

- comply with the balance sheet and profit and loss format requirements in Section B of Part 1 of Schedule 1 to the Regulations (i.e. use 'statutory formats'); or
- adapt one of the balance sheet or profit and loss account formats in Section B of Part 1 of Schedule 1 to the Regulations (i.e. use 'adapted formats') so as:
  - (in the case of the balance sheet) to distinguish between current and non-current items in a different way; and
  - provided that (for both the balance sheet and profit and loss account):
    - the information given is at least equivalent to that which would have been required by the use of such format had it not been thus adapted; and
    - the presentation is in accordance with generally accepted accounting principles or practice. *[1 Sch 1A]*.

The LLP Regulations allow the same choice for LLPs. *[1 Sch 1A (LLP)]*.

The choice to apply the adapted balance sheet and profit and loss formats (i.e. the presentation requirements of IAS 1) is available only for those entities applying Schedule 1 to the Regulations or the LLP Regulations. The choice is not available to entities applying Schedule 2 to the Regulations (banking companies) or Schedule 3 to the Regulations (insurance companies).

FRS 101 states that when a qualifying entity chooses to use the adapted formats as described above, it should apply the relevant presentation requirements of IAS 1 and, in addition, the profit and loss account (whether presented as a component of the statement of comprehensive income, or as a separate statement) should disclose 'profit or loss before taxation'. *[FRS 101.AG1(h)-(i)]*. The presentation requirements of IAS 1 are discussed in Chapter 3 at 3 of EY International GAAP 2019.

A qualifying entity not permitted or not choosing to apply the adapted formats, *[1 Sch 1A(1)-(2)]*, should comply with the balance sheet format requirements and present the components of profit or loss in the statement of comprehensive income (in either the single statement or two statement approach) in accordance with the profit and loss account formats of the CA 2006 (i.e. the statutory formats), instead of paragraphs 54 to 76, 82, and 85 to 86 of IAS 1.

A qualifying entity should apply, as required by company law, either Part 1 'General Rules and Formats' of Schedule 1 to the Regulations; Part 1 'General Rules and Formats' of Schedule 2 to the Regulations; Part 1 'General Rules and Formats' of Schedule 3 to the Regulations; or Part 1 'General Rules and Formats' of Schedule 1 to the LLP Regulations ('the General Rules to the formats'). *[FRS 101.AG1(h)-(i)]*.

The General Rules to the formats apply to statutory formats. So far as is practicable, the General Rules to the formats (set out in paragraphs 2 to 9A of Section A of Part 1 of Schedule 1 to the Regulations) also apply to the adapted formats. *[1 Sch 1A(3)]*. There are similar requirements in the LLP Regulations. The General Rules to the formats are discussed in Chapter 6 at 4.4.

When an asset or liability relates to more than one item in the balance sheet, the relationship of such asset or liability to the relevant items must be disclosed either under those items or in the notes to the accounts. *[1 Sch 9A]*. This requirement in the General Rules to the formats applies to both statutory and adapted formats.

Therefore, banking and insurance companies, as well as those entities applying Schedule 1 to the Regulations but choosing not to use the adapted formats, must use the statutory balance sheet and profit and loss account formats set out in Section B of Part 1 of the relevant schedule to the Regulations. The legal appendix to FRS 101 confirms that the requirements of paragraphs 54 to 76, 82 and 85 to 86 of IAS 1 do not apply unless the adapted formats in Schedule 1 to the Regulations (i.e. the option to use the IAS formats) are chosen. *[FRS 101 Appendix II Table 1]*.

FRS 101 can also be applied by qualifying entities not subject to the Regulations or the LLP Regulations. The requirements in the Application Guidance to FRS 101 apply to all entities not just companies. *[FRS 101.5(b)]*. A qualifying entity must also ensure it complies with any relevant legal requirements applicable to it. *[FRS 101.4A]*. FRS 102 is more specific and requires entities to apply the formats included in one of Schedules 1, 2 or 3 to the Regulations or the LLP Regulations (so allowing the choice of statutory or adapted formats where Schedule 1 to the Regulations or the LLP Regulations are applied), except to the extent that these requirements are not permitted by any statutory framework under which such entities report. *[FRS 102.4.1, 4.2, 5.1, 5.5, 5.7]*. It seems likely a similar approach is intended under FRS 101.

The required format to be used by a qualifying entity that is not a company or an LLP may be determined by the legal framework governing the financial statements of such entities (see discussion in Chapter 6 at 4.2 on which formats apply to different types of entities). In other cases, management of such entities must apply judgement in determining the most appropriate format in the Regulations or LLP Regulations to use for the circumstances of the entity concerned, where the statutory framework is not prescriptive.

The General Rules to the formats to Schedule 1 to the Regulations state that once a particular format (in Section B of Part 1 to that schedule) for the balance sheet (or profit and loss account) has been adopted for any financial year, the company's directors must use the same format in preparing Companies Act accounts for subsequent financial years, unless in their opinion there are special reasons for a change. Particulars of any such change must be given in a note to the accounts in which the new format is first used, and the reasons for the change must be explained. *[1 Sch 2, 6 Sch 1]*. Schedule 1 to the Regulations provides a choice of two balance sheet and two profit and loss account statutory formats. There is a similar requirement in the LLP Regulations. There is, however, no choice of statutory formats available in Schedules 2 or 3 of the Regulations.

The above paragraph is discussing a change in the statutory format adopted but, as the paragraph is included in the General Rules to the formats, its requirements apply so far as is practicable where adapted formats are used.

FRS 101 is silent on how an entity would implement a change from a statutory balance sheet and profit and loss account format to an IAS 1 format (i.e. adapted format) (or *vice versa*) in an accounting period subsequent to adoption of FRS 101. In our view, this is a voluntary change in accounting policy to which IAS 8 applies. Consequently, the change should be applied retrospectively, prior periods should be restated and the disclosures required by paragraph 29 of IAS 8 must be made (as well as the disclosures required by the Regulations described above).

5.1.1 Additional presentation requirements where an entity is using the adapted (IAS 1) balance sheet and profit and loss account formats

The legal appendix to FRS 101 clarifies that an entity applying the adapted balance sheet and profit and loss account formats – see 5.1 above – should apply the relevant presentation requirements of IAS 1 subject to: *[FRS 101 Appendix II.9A]*

- the disclosure of profit or loss before taxation and the amendment to IFRS 5 – *Non-current Assets Held for Sale and Discontinued Operations* – included in paragraph AG1(g) of FRS 101, as set out at 5.4 below; and
- any further disaggregation of the statement of financial position, for example in relation to trade and other receivables and trade and other payables (which may be provided in the notes to the financial statements), that is necessary to meet the requirement to give the equivalent information.

The legal appendix does not elaborate what is meant by a 'further disaggregation of the statement of financial position' other than provide the examples above. It reiterates that the option to apply the presentation requirements of IAS 1 is not available to a qualifying entity applying Schedule 2 or Schedule 3 to the Regulations. *[FRS 101 Appendix II.9A]*.

The presentation requirements of IAS 1 are discussed in Chapter 3 of EY International GAAP 2019. IAS 1 permits an entity to present assets and liabilities in the statement of financial position in order of liquidity instead of a current/non-current basis if presentation in order of liquidity is reliable and more relevant. *[IAS 1.60]*. In our view, FRS 101 does not permit the use of a liquidity presentation for assets and liabilities. The use of the adapted formats is intended only to allow an entity to distinguish between current and non-current items in a different (i.e. IFRS) way from the current/non-current presentation required by the statutory formats in Schedule 1 to the Regulations (and the LLP Regulations). The adapted formats do not permit a basis of presentation other than current/non-current.

The Regulations (and LLP Regulations) require supplementary information to be given in the notes to the accounts. These disclosure requirements apply where statutory formats or adapted formats are used. One complexity is that the information required sometimes refers to items found in the statutory formats (which may differ to the line items identified where the adapted formats are used). For example, the adapted formats do not refer to fixed assets, creditors: amounts falling due within one year, creditors: amounts falling due after more than one year, investments, land or buildings, or turnover. Therefore, a UK company using adapted formats in Companies Act accounts will need to identify which of its assets, liabilities, revenue streams needs to be included in the required disclosures. While the classification of non-current assets and current assets used in adapted formats differs to the fixed assets and current assets classification required in statutory formats, the statutory definition of 'fixed assets' (see Chapter 6 at 5.2.2) is relevant for the purposes of disclosures in respect of fixed assets in the Regulations.

5.1.2 Additional presentation requirements needed to comply with IFRS by an entity using the Companies Act balance sheet and profit and loss account formats (statutory formats)

The legal appendix to FRS 101 clarifies that for a qualifying entity not permitted or not choosing to apply the adapted (i.e. IAS 1) balance sheet or profit and loss account formats – see 5.1 above – the format and presentation requirements of IAS 1 may conflict with those of company law because of the following: *[FRS 101 Appendix II.9B]*

- differences in the definition of 'fixed assets' (the term used in the Regulations meaning assets which are intended for use on a continuing basis in the entity's activities) and 'non-current assets' (the term used in EU-adopted IFRS). See Chapter 6 at 5.1.1 and 5.2.2;
- differences in the definition of 'current assets' as the term is used in the Regulations and EU-adopted IFRS. See Chapter 6 at 5.1.1 and 5.2.2;
- differences in the definition of 'creditors: amounts falling due within or after more than one year' (the terms used in the Regulations) and 'current and non-current liabilities' (the terms used in EU-adopted IFRS). See Chapter 6 at 5.1.2 and 5.2.3. Under the CA 2006, a loan is treated as due for repayment on the earliest date on which a lender could require repayment, whilst under EU adopted IFRS the due date is based on when the entity expects to settle the liability or has no unconditional right to defer payment; and
- the CA 2006 requires presentation of debtors falling due after more than one year within current assets. Under EU-adopted IFRS, these items will (usually) be presented in non-current assets. The legal appendix to FRS 101 provides further guidance on the presentation of debtors falling due after more than one year (which are shown in current assets) in the statutory formats – see 5.1.2.A below.

The statutory formats for the balance sheet and profit and loss account (and the related notes to the formats that should be followed) in Schedule 1 to the Regulations and the LLP Regulations are discussed in Chapter 6 at 5.2, 5.3 and 6.6.

5.1.2.A Debtors due after more than one year

The statutory balance sheet formats require all debtors to be shown under 'current assets'. However, the Regulations require the amount falling due after more than one year to be shown separately for each item included under debtors. The Note on Legal Requirements to FRS 101 reproduces the consensus of UITF 4 – *Presentation of long-term debtors in current assets* – that 'in most cases it will be satisfactory to disclose the size of debtors due after more than one year in the notes to the accounts. There will be some instances, however, where the amount is so material in the context of the total net current assets that in the absence of disclosure of debtors due after more than one year on the face of the balance sheet readers may misinterpret the accounts. In such circumstances, the amount should be disclosed on the face of the balance sheet within current assets'. *[FRS 101 Appendix II.10]*.

This disclosure is only relevant where statutory formats rather than adapted (i.e. IAS 1) formats are applied.

5.1.2.B Non-current assets or disposal groups held for sale

IFRS 5 requires an entity to present: *[IFRS 5.38]*

- a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the statement of financial position; and
- the liabilities of a disposal group classified as held for sale separately from other liabilities in the statement of financial position.

IAS 1 requires a single line approach in the balance sheet for 'the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with IFRS 5' and for 'liabilities included in disposal groups classified as held for sale in accordance with IFRS 5'. Detailed analysis of the components of the assets and liabilities held for sale is required in the notes to the financial statements. *[IAS 1.54]*.

However, a qualifying entity that has a disposal group classified as held for sale must ensure that its presentation of the disposal group, in accordance with IFRS 5, meets company law requirements. The Note on Legal Requirements to FRS 101 states that a single line presentation of non-current assets (or liabilities) held for sale will usually not meet company law requirements when the Company Law formats are applied. Therefore, additional aggregation should be provided either in the statement of financial position or in the notes. When the items are material, this should be on the face of the statement of financial position. *[FRS 101 Appendix II.10A]*. This conflict arises because the statutory formats included in the Regulations (and LLP Regulations) do not otherwise permit the aggregation of different types of assets and liabilities in this way. One practical solution could be to present the disposal group aggregations as a memorandum on the statement of financial position cross-referenced to the detailed analysis in the notes.

5.2 Notes to the financial statements

Schedule 1 to the Regulations (and its equivalents in Schedule 2 and Schedule 3 and the LLP Regulations) require the notes to the financial statements to be presented in the order in which, where relevant, the items to which they relate are presented in the statement of financial position and the income statement. *[1 Sch 42(2)]*. A qualifying entity preparing financial statements in accordance with FRS 101 should have regard to this requirement when determining a systematic manner for the presentation of its notes to the financial statements in accordance with paragraphs 113 and 114 of IAS 1. *[FRS 101 Appendix II.11A]*.

5.2.1 Particulars of turnover

Schedule 1 to the Regulations (and its equivalents in Schedule 2 and Schedule 3 and the LLP Regulations) require particulars of turnover to be disclosed, including the amount of turnover attributable to each class of business carried on by the company. Where relevant, turnover attributable to different markets must also be disclosed. Although FRS 101 provides an exception from paragraph 114 of IFRS 15, the requirements of the Regulations should still be complied with. *[FRS 101 Appendix II.11B]*.

5.3 Extraordinary items

IFRS has no concept of 'extraordinary items'. The concept of extraordinary items has also been removed for entities applying Schedule 1 to the Regulations or the LLP Regulations.

Consequently, only entities applying Schedule 2 or Schedule 3 to the Regulations (i.e. banking companies and insurance companies) are still required to present extraordinary items separately in the profit and loss account. However, we would expect this requirement to have no practical impact as we would not expect to see any extraordinary items under FRS 101. The legal appendix to FRS 101 states that 'entities should note that extraordinary items are extremely rare as they relate to highly abnormal events or transactions'. *[FRS 101 Appendix II.11]*.

Ordinary activities (for entities reporting under Schedule 2 or Schedule 3 to the Regulations) are defined as 'any activities which are undertaken by a reporting entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from, these activities. Ordinary activities include any effects on the reporting entity of any event in the various environments in which it operates, including the political, regulatory, economic and geographical environments, irrespective of the frequency or unusual nature of the events'. *[FRS 101.AG1(j)]*.

Extraordinary activities are 'material items possessing a high degree of abnormality which arise from events or transactions that fall outside the ordinary activities of the reporting entity and which are not expected to recur. They do not include items occurring within the entity's ordinary activities that are required to be disclosed by IAS 1.97, nor do they include prior period items merely because they relate to a prior period'. *[FRS 101.AG1(j)]*.

5.4 Presentation of discontinued operations

FRS 101 amends IFRS 5 to: *[FRS 101.AG1(g)]*

- remove the option to present the analysis of discontinued operations into its component parts (i.e. revenue, expenses, pre-tax profit, related income tax expense, gain or loss on remeasurement to fair value less costs to sell or on disposal of the discontinued operation and the related income tax expense) in the notes to the financial statements. This analysis must be presented on the face of the statement of comprehensive income;
- require the analysis above to be shown on the face of the statement of comprehensive income in a column identified as related to discontinued operations (i.e. separately from continuing operations);
- require a total column (i.e. the sum of continuing and discontinued operations) to be presented on the face of the statement of comprehensive income; and
- remove the option to present income from continuing operations and from discontinued operations attributable to owners of the parent in the notes to the financial statements. This analysis must be presented on the face of the statement of comprehensive income.

This amended presentation is required for all entities applying FRS 101, even those who have chosen to apply the adapted (i.e. IAS 1) balance sheet and profit and loss account presentation formats (see 5.1 above).

In substance, this means that the single line presentation of discontinued operations in IFRS is replaced by a three-column approach with the detailed analysis of the results from the discontinued operation shown on the face of the statement of comprehensive income. This is illustrated in the following example which uses the Schedule 1 statutory formats:

Example 2.1: Example of presentation of discontinued operations (statutory format)

Statement of comprehensive income
For the year ended 31 December 2019

	Continuing operations 2019 £000	Dis-continued operations 2019 £000	Total 2019 £000	Continuing operations 2018 £000	Dis-continued operations 2018 £000	Total 2018 £000
Turnover	4,200	1,232	5,432	3,201	1,500	4,701
Cost of Sales	(2,591)	(1,104)	(3,695)	(2,281)	(1,430)	(3,711)
Gross profit	1,609	128	1,737	920	70	990
Administrative expenses	(452)	(110)	(562)	(418)	(120)	(538)
Other operating income	212	–	212	198	–	198
Operating profit	1,369	18	1,387	700	(50)	650
Profit on disposal of operations		301	301		-	-
Interest receivable and similar income	14	–	14	16	–	16
Interest payable and similar expenses	(208)	–	(208)	(208)	–	(208)
Profit before tax	1,175	319	1,494	508	(50)	458
Tax on profit or loss	(390)	(4)	(394)	(261)	3	(258)
Profit after taxation and profit for the financial year	785	315	1,100	247	(47)	200

Other comprehensive income		
Remeasurement changes on defined benefit pension plans	(108)	(68)
Deferred tax movement relating to remeasurement changes	28	18
Total Comprehensive income for the year	1,020	150

6 DISCLOSURE EXEMPTIONS FOR QUALIFYING ENTITIES

Qualifying entities may take advantage in their financial statements of a number of disclosure exemptions from EU-adopted IFRS (see 6.1 below).

Qualifying entities that are financial institutions, as defined by FRS 101, are not entitled to some disclosure exemptions (see 6.4 below).

Some, but not all, of these exemptions are conditional on 'equivalent' disclosures in the consolidated financial statements of the group in which the entity is consolidated (see 6.2 below).

In addition, disclosures required by the Regulations (or the LLP Regulations) for certain financial instruments that are held at fair value must be made even if the qualifying entity takes advantage of the disclosure exemptions from the disclosure requirements of IFRS 7 – *Financial Instruments: Disclosures* – and/or IFRS 13 – *Fair Value Measurement* (see 6.3 below). *[FRS 101 Appendix II.5A]*.

6.1 Disclosure exemptions

Qualifying entities are permitted the following disclosure exemptions from EU-adopted IFRS from when the relevant standard is applied: *[FRS 101.7-8]*

- the requirement of paragraphs 6 and 21 of IFRS 1 to present an opening statement of financial position at the date of transition and related notes on first-time adoption of FRS 101 (see 3.4 above);
- the requirements of paragraphs 45(b) and 46 to 52 of IFRS 2 – *Share-based Payment* – provided that for a qualifying entity that is:
  - a subsidiary, the share-based payment arrangement concerns equity instruments of another group entity;
  - an ultimate parent, the share-based payment arrangement concerns its own equity instruments and its separate financial statements are presented alongside the consolidated financial statements of the group;

  and, in both cases, provided that equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated (see 6.1.1 below);
- the requirements of paragraphs 62, B64(d), (e), (g), (h), (j) to (m), n(ii), (o)(ii), (p), (q)(ii), B66 and B67 of IFRS 3 provided that equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated (see 6.1.2 below);
- the requirements of paragraph 33(c) of IFRS 5 provided that equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated (see 6.1.3 below);

- the requirements of IFRS 7 provided that equivalent disclosures are included in the financial statements of the group in which the entity is consolidated (see 6.1.4 below). However, entities which are subject to the CA 2006 and the Regulations (or the LLP Regulations) are legally required to provide disclosures related to financial instruments including those measured at fair value (see 6.3 and 7.2 below). Qualifying entities that are financial institutions do not receive this exemption and must apply the disclosure requirements of IFRS 7 in full (see 6.4 below);
- the requirements of paragraphs 91 to 99 of IFRS 13 provided that equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated (see 6.1.5 below). However, entities which are subject to the CA 2006 and the Regulations (or the LLP Regulations) are legally required to provide disclosures related to financial instruments including those measured at fair value (see 6.3 and 7.2 below). Qualifying entities that are financial institutions can only take advantage of the exemptions to the extent that they apply to assets and liabilities other than financial instruments (see 6.4 below);
- the requirements of the second sentence of paragraph 110 and paragraphs 113(a), 114, 115, 118, 119(a) to (c), 120 to 127 and 129 of IFRS 15 (see 6.1.6 below).
- the requirements of paragraph 52, the second sentence of paragraph 89, and paragraphs 90, 91 and 93 of IFRS 16 as well as the requirements of paragraph 58 of IFRS 16, provided that the disclosure of details of indebtedness required by paragraph 61(1) of Schedule 1 to the Regulations is presented separately for lease liabilities and other liabilities, and in total (see 6.1.7 below);
- the requirement in paragraph 38 of IAS 1 to present comparative information in respect of:
  - paragraph 79(a)(iv) of IAS 1;
  - paragraph 73(e) of IAS 16;
  - paragraph 118(e) of IAS 38 – *Intangible Assets*;
  - paragraphs 76 and 79(d) of IAS 40 – *Investment Property*; and
  - paragraph 50 of IAS 41 – *Agriculture* (see 6.1.8 below);
- the requirements of paragraphs 10(d), 10(f), 16, 38A to 38D, 40A to 40D, 111 and 134 to 136 of IAS 1 (see 6.1.9 below). However, qualifying entities that are financial institutions are not permitted to take advantage of the exemptions in paragraphs 134 to 136 of IAS 1 (see 6.4 below);
- the requirements of IAS 7 – *Statement of Cash Flows* (see 6.1.10 below);
- the requirements of paragraphs 30 and 31 of IAS 8 (see 6.1.11 below);

- the requirements of paragraphs 17 and 18A of IAS 24 – *Related Party Disclosures* – and the requirements in IAS 24 to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member (see 6.1.12 below); and
- the requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) of IAS 36 – *Impairment of Assets* – provided that equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated (see 6.1.13 below).

When a paragraph within a given standard cross-refers to the requirements of an exempted paragraph listed above, the qualifying entity is nevertheless permitted to take the exemption in the exempted paragraph. *[FRS 101.8A]*.

Use of the disclosure exemptions is conditional on the following disclosures in the notes to the financial statements: *[FRS 101.5(c)]*

(a) a brief narrative summary of the exemptions adopted; and

(b) the name of the parent of the group in whose consolidated financial statements the reporting entity is consolidated and from where those financial statements may be obtained (i.e. the parent identified in the term 'qualifying entity').

There is no requirement to list all of the disclosure exemptions in detail. Reporting entities can also choose to apply the disclosure exemptions on a selective basis. This may be necessary, for example, where not all of the relevant 'equivalent' disclosures are made in the consolidated financial statements of the parent on the grounds of materiality (see 6.2 below).

Each of the disclosure exemptions listed above is discussed below.

6.1.1 Share-based payment (IFRS 2)

The disclosure exemption eliminates all IFRS 2 disclosures apart from those required by paragraphs 44 and 45(a), (c) and (d) of IFRS 2. In summary, this reduces the specific minimum disclosure requirements of IFRS 2 to:

- a description of each type of share-based payment arrangements that existed during the reporting period, including general terms and conditions, the maximum terms of options granted, and the method of settlement (e.g. whether in cash or equity);
- the weighted average share price at the date of exercise for share options exercised during the reporting period (or the weighted average share price during the period, if options were exercised on a regular basis throughout the period); and
- the range of exercise prices and weighted average remaining contractual life for share options outstanding at the end of the reporting period.

In addition, an entity is still subject to the general disclosure objective of IFRS 2 to disclose information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period which may require additional disclosures beyond those specially required above.

6.1.2 Business combinations (IFRS 3)

In summary, this disclosure exemption eliminates the qualitative disclosures required for a business combination. However, a number of factual or quantitative disclosures are still required for each business combination including:

- the name and description of the acquiree, acquisition date and percentage of voting equity interests acquired;
- the acquisition-date fair value of total consideration transferred split by major class;
- the amount recognised at the acquisition date for each major class of assets acquired and liabilities assumed;
- the amount of any negative goodwill recognised and the line item in the statement of comprehensive income in which it is recognised;
- the amount of any non-controlling interest recognised and the measurement basis for the amount (although there should be no non-controlling interests for acquisitions in individual financial statements);
- the amounts of revenue and profit or loss of the acquiree since acquisition date included in comprehensive income for the period; and
- the information above (except for the information in the first bullet) in aggregate for individually immaterial business combinations that are collectively material.

In addition, an acquirer is still subject to the general requirements of paragraphs 59 to 61 of IFRS 3 which may require additional disclosures beyond those specially required. These require disclosure of information that enables users of the financial statements to evaluate the nature and effect of a business combination that occurs, either during the current reporting period or at the end of the financial reporting period but before the financial statements are authorised for issue. These paragraphs also require disclosure of information that enables users of the financial statements to evaluate the financial effects of adjustments recognised in the current reporting period relating to business combinations that occurred in the current or previous periods.

6.1.3 Discontinued operations (IFRS 5)

This exemption eliminates the requirement to disclose cash flows attributable to discontinued operations. This cash flow disclosure exemption is contingent on equivalent disclosures in the consolidated financial statements of the parent, although equivalent disclosures in the parent are not necessary to make use of the exemption not to prepare a cash flow statement.

6.1.4 Financial instruments (IFRS 7)

This exemption removes all of the disclosure requirements of IFRS 7. However, notwithstanding this exemption, some IFRS 7 disclosures are still required for certain financial instruments measured at fair value (see 6.3 below). In addition, some specific financial instruments disclosures are required by the Regulations or the LLP Regulations (see 7.2 below).

Financial institutions are not permitted to use this exemption (see 6.4 below).

6.1.5 Fair values (IFRS 13)

This exemption removes all of the disclosure requirements of IFRS 13. However, notwithstanding this exemption, some IFRS 13 disclosures are still required for certain financial instruments measured at fair value (see 6.3 below). In addition, specific disclosures in respect of the fair value of stocks, financial instruments, investment property and living animals and plants carried at fair value are required by the Regulations (see 6.3 and 7.2 below).

Financial institutions are not permitted to use this IFRS 13 disclosure exemption in respect of financial instruments. However, they can use this exemption in respect of fair value disclosures of non-financial assets and liabilities (see 6.4 below).

6.1.6 Revenue from contracts with customers (IFRS 15)

IFRS 15 is effective for accounting periods beginning on or after 1 January 2018 but can be applied early.

The intention of these disclosure exemptions is to confine the revenue disclosures to those that the FRC consider would be of relevance to a provider of credit to a qualifying entity (identified as being the likely external users of a qualifying entity's financial statements). That is, information supporting the statement of financial position rather than the income statement. *[FRS 101.BC48]*. Hence, exemptions are given from the following disclosures:

- the disclosure objectives (paragraph 110);
- revenue recognised from contracts with customers (paragraph 113(a));
- disaggregation of revenue (paragraph 114);
- disclosure of the relationship between disaggregated revenue and revenue information disclosed for each reportable segment, if IFRS 8 – *Operating Segments* – is applied (paragraph 115);
- a qualitative and quantitative explanation of significant changes in contract assets and contract liabilities during the reporting period (paragraph 118);
- information about satisfying performance obligations, significant payment terms and the nature of goods and services transferred (paragraphs 119(a)-(c));
- information about allocating the transaction price to performance obligations (paragraphs 120 to 122);
- significant judgements made in applying IFRS 15 (paragraph 123);
- the methods used to recognise revenue satisfied over time; and, for performance obligations satisfied at a point in time, the significant judgements in evaluating when a customer obtains control (paragraphs 124 and 125);
- information about the methods, inputs and assumptions used for determining the transaction price, assessing whether the estimate of variable consideration is constrained, allocating the transaction price, and measuring obligations for returns, refunds and other similar obligations (paragraph 126);
- judgements made in determining costs to obtain and fulfil a contract with a customer, and the method used to determine amortisation of those costs (paragraph 127); and
- the use of any practical expedients concerning the existence of significant financing components or the incremental costs of obtaining a contract (paragraph 129).

Qualifying entities are still required to make the following specific disclosures:

- impairment losses on receivables or contract assets arising from an entity's contracts with customers, to be disclosed separately from impairment losses on other contracts (paragraph 113(b));
- the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers (paragraph 116(a));
- revenue recognised in the reporting period included in the contract liability at the beginning of the period (paragraph 116(b));
- revenue recognised in the reporting period from performance obligations satisfied or partially satisfied in prior periods (paragraph 116(c));
- an explanation (which may use qualitative information) as to how the timing of satisfaction of performance obligations relates to the typical timing of payment and the effect that those factors have on the contract asset and liability balances (paragraph 117);
- a description of obligations for return, refunds and other similar obligations; and types of warranties and related obligations (paragraph 119(d)-(e)); and
- the closing balances of assets recognised from the costs incurred to obtain or fulfil a contract by main category of asset; and the amount of amortisation and impairment in the reporting period (paragraph 128).

Qualifying entities are also still required to make the following disclosure requirements:

- company law requirements relating to disaggregation of turnover (see 5.2.1 above); and
- the requirements of IAS 1 related to judgements having a significant effect on the amounts recognised in the entity's financial statements. *[FRS 101.BC49]*.

The Basis for Conclusions also clarifies that, for the avoidance of doubt, although paragraph 117 of IFRS 15 (from which a qualifying entity is not exempt) cross-refers to paragraph 119, it is not necessary to comply with paragraph 119 in order to meet the requirements of paragraph 117. *[FRS 101.8A, BC50]*.

6.1.7 Leases (IFRS 16)

IFRS 16 is effective for accounting periods beginning on or after 1 January 2019 but can be applied early as long as IFRS 15 is also applied. *[IFRS 16 Appendix C.1]*.

The intention of the disclosure exemptions for lessors is to provide similar disclosure exemptions to those given from disclosures in IFRS 15. *[FRS 101.BC61]*. The disclosure exemptions are as follows:

- the requirement for a lessee to provide all lease disclosures in a single note or separate section in its financial statements (paragraph 52);
- a lessee's maturity analysis of lease liabilities, separately from that of other financial liabilities (paragraph 58) provided that the disclosure of details of indebtedness required by paragraph 61(1) of Schedule 1 to the Regulations is presented separately for lease liabilities and other liabilities, and in total;
- the sentence that states that paragraphs 90 to 97 specify requirements on how to meet the disclosure objective for lessors (second sentence of paragraph 89). Some of these disclosures are not required;

- a lessor's lease income, finance income and selling profit/loss disclosures (paragraphs 90 to 91); and
- a qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in finance leases (paragraph 93).

The exemption from the requirement of a lessee to provide all lease disclosures in a single note (or separate section in the financial statements) is provided because the FRC consider that it would result in unnecessary additional work that would provide minimal additional benefits to the users of the financial statements. This is because paragraph 42(2) of Schedule 1 to the Regulations (and its equivalents in Schedule 2 and Schedule 3 to the Regulations and the LLP Regulations) require entities to present the notes to the accounts in the order in which, where relevant, the items to which they relate are presented in the balance sheet and in the profit and loss account. *[FRS 101.BC52-54]*.

The exemption from the requirement for lessees to disclose a maturity analysis of lease liabilities is provided because FRS 101 provides an exemption for non-financial institutions from the maturity analysis requirements of IFRS 7 for financial liabilities (provided that equivalent disclosures are included in the consolidated financial statements of the group in which the qualifying entity is included). However, this exemption is conditional on an entity providing the company law disclosures about details of indebtedness separately for lease liabilities and other liabilities, and in total. This is because it was considered that users would find separate disclosures of lease liabilities useful. *[FRS 101.BC55-59]*.

An exemption from paragraphs 94 and 97 of IFRS 16 (which require lessors to provide a maturity analysis of finance and operating lease receivables) was not introduced as no equivalent requirements exist under company law and the FRC consider that these maturity analyses provide useful information to users about the lessor's liquidity and solvency. *[FRS 101.BC60]*. Apart from the exemptions above, lessees and lessors are subject to the detailed disclosure requirements of IFRS 16.

6.1.8 Comparatives (IAS 1, IAS 16, IAS 38, IAS 40, IAS 41)

This exemption eliminates the requirement for comparatives to be presented for reconciliations of:

- outstanding shares at the beginning and end of the current period (IAS 1);
- the carrying amount of property, plant and equipment at the beginning and end of the current period (IAS 16);
- the carrying amount of intangible assets at the beginning and end of the current period (IAS 38);
- the carrying amount of investment property held at either fair value or cost at the beginning and end of the current period (IAS 40); and
- the carrying amount of biological assets at the beginning and end of the current period (IAS 41).

6.1.9 Presentation (IAS 1)

This exemption removes:

- the requirement to present a cash flow statement (paragraphs 10(d) and 111 – see 6.1.10 below);
- the requirement to present a statement of financial position and related notes at the beginning of the earliest comparative period (or third balance sheet) whenever an entity applies an accounting policy retrospectively, makes a retrospective restatement, or when it reclassifies items in its financial statements (paragraph 10(f) and paragraphs 40A-40D);
- the requirement to make an explicit statement of compliance with IFRS. Indeed, FRS 101 prohibits such a statement of compliance and an FRS 101 statement of compliance is required instead (paragraph 16 – see 1.3 above);
- the requirements to present two primary statements as a minimum, information about narrative information in previous reporting periods relevant to understanding the current period's financial statements, and the suggestion that entities may present additional comparative information (paragraphs 38A-38D); and
- the requirement to disclose information about capital and how it is managed (paragraphs 134-136).

Financial institutions are not permitted to use the exemption in respect of the disclosure of information about capital and how it is managed. This is because financial institutions are usually subject to externally imposed capital requirements.

6.1.10 Cash flows (IAS 7)

The exemption removes the requirement for a cash flow statement for any qualifying entity.

6.1.11 Standards issued but not effective (IAS 8)

This exemption removes the requirement to provide information about the impact of IFRSs that have been issued but are not yet effective.

6.1.12 Related party transactions (IAS 24)

The exemptions in respect of IAS 24 remove:

- the requirement to disclose information about key management personnel compensation (paragraphs 17);
- the requirement to disclose amounts incurred for the provision of key management personnel services that are provided by a separate management entity (paragraph 18A); and
- the requirements to disclose related party *transactions* between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member.

The last disclosure exemption above refers to transactions only and not to outstanding balances. As explained in the Basis for Conclusions to FRS 102, this is because there is a separate legal requirement in relation to the format of the balance sheet which requires disclosure of outstanding balances in aggregate for group undertakings and, separately, for undertakings in which the company has a participating interest. As a result, it is not possible to provide an effective exemption from the disclosure of outstanding balances with group undertakings. *[FRS 102.BC.B33.2]*.

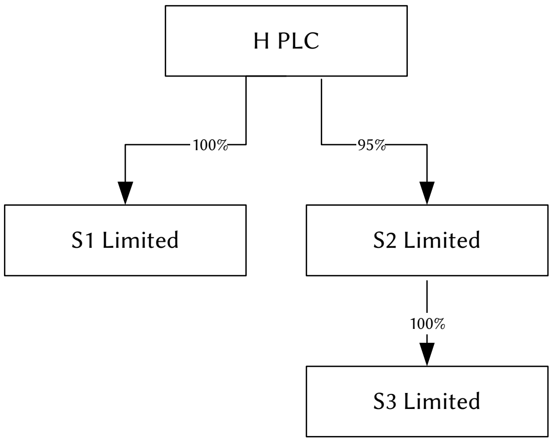
Although the requirement to disclose information about key management personnel compensation is eliminated, UK companies are required separately by Schedule 5 to the Regulations to disclose information in respect of directors' remuneration. Additionally, quoted companies must prepare a directors' remuneration report. There is no exemption from other IAS 24 disclosure requirements, so disclosure of other transactions with key management personnel (e.g. director loans) is still required.

The wording of the exemption from disclosure of transactions with other wholly owned subsidiaries has been taken directly from the Regulations. *[FRS 101.BC68]*. It is stated in the Basis for Conclusions that, in December 2017, amendments were made to Appendix II: *Note on legal requirements* to FRS 102 to clarify the FRC's view that: *[FRS 101.BC69]*

- the exemption may be applied to transactions between entities within a sub-group when the transacting subsidiary is wholly-owned by the intermediate parent of that sub-group, even if that intermediate parent is not wholly-owned by the ultimate controlling entity; and
- the exemption may not be applied to transactions between entities in an intermediate parent's sub-group (including the intermediate parent itself) and the entities in the larger group if the intermediate parent is not wholly-owned by the parent of that larger group.

This is illustrated by Example 2.2 below.

Example 2.2: Application of the exemption from disclosure of transactions between wholly-owned subsidiary undertakings



Because H PLC only owns 95% of S2 Limited, the wholly owned subsidiaries exemption cannot be used in (a) the separate financial statements of H PLC in respect of transactions with S2 Limited and S3 Limited, (b) the individual financial statements of S1 Limited in respect of transactions with S2 Limited and S3 Limited (c) the separate financial statements of S2 Limited in respect of any transactions with H PLC and S1 Limited or (d) the individual financial statements of S3 Limited in respect of any transactions with H PLC and S1 Limited.

The exemption can be used for any transactions in individual financial statements between H PLC and S1 Limited and between S2 Limited and S3 Limited.

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However, if the remaining 5% of S2 Limited (not directly held by H PLC) was held by another wholly owned subsidiary undertaking of H PLC, then S2 Limited would be a wholly owned subsidiary undertaking of H PLC. In those circumstances, the exemption from disclosing transactions with the other entities in the group should be available in the individual financial statements of H PLC, S1 Limited, S2 Limited and S3 Limited (as S1 Limited, S2 Limited and S3 Limited would all be wholly owned subsidiary undertakings of the H PLC group).

The exemption has no other conditions: it can be applied, for example, to an entity with an overseas parent.

6.1.13 Impairment of assets (IAS 36)

This exemption eliminates all requirements to disclose information about estimates used to measure recoverable amounts of each cash-generating unit (or group of units) containing goodwill or intangible assets with indefinite useful lives, including details of fair value measurements where the recoverable amount is fair value less costs of disposal other than:

- the carrying amounts of goodwill and carrying amounts of indefinite life intangibles allocated to each such cash generating unit (or group of units) (paragraphs 134(a), 134(b), 135(a), 135(b)); and
- the basis on which the recoverable amount of those units has been determined (i.e. value in use or fair value less costs of disposal) (paragraph 134(c)).

Qualifying entities must still give the other disclosures required by paragraphs 126 to 135 of IAS 36 in respect of impairment losses (and reversal of impairment losses) recognised or reversed in the period. These include, *inter alia*, the recoverable amount of the asset (or cash generating unit) and whether the recoverable amount is its fair value less costs of disposal or its value in use. However, where an impairment loss has been recognised or reversed during the period in respect of an individual asset (including goodwill) or a cash-generating unit, and the recoverable amount was based on fair value less costs of disposal, the information on the valuation techniques used (and the key assumptions) for fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy are not required.

6.2 'Equivalent' disclosures

Certain of the disclosure exemptions in FRS 101 are dependent on the provision of 'equivalent' disclosures in the publicly available consolidated financial statements of the parent in which the entity is included.

The following table summarises which disclosure exemptions need 'equivalent' disclosures in the consolidated financial statements of the parent and which do not.

Disclosure exemption	*Equivalent disclosures required in parent consolidated financial statements*
First-time adoption exemption (see 6.1 above)	No
Share-based payment (see 6.1.1 above)	Yes
Business combinations (see 6.1.2 above)	Yes
Discontinued operations (see 6.1.3 above)	Yes
Financial instruments (see 6.1.4 above)	Yes
Fair values (see 6.1.5 above)	Yes

Revenue from Contracts with Customers (see 6.1.6 above)	No
Leases (see 6.1.7 above)	No
Comparatives (see 6.1.8 above)	No
Presentation (see 6.1.9 above)	No
Cash flows (see 6.1.10 above)	No
Standards issued but not effective (see 6.1.11 above)	No
Related party transactions (see 6.1.12 above)	No
Impairment of assets (see 6.1.13 above)	Yes

FRS 101 refers to the Application Guidance in FRS 100 in deciding whether the consolidated financial statements of the group in which the reporting entity is included provides disclosures that are 'equivalent' to the requirements of EU-adopted IFRS from which relief is provided. *[FRS 101.9]*.

The Application Guidance in FRS 100 states that:

- it is necessary to consider whether the publicly available consolidated financial statements of the parent provide disclosures that meet the basic disclosure requirements of the relevant standard or interpretation issued (or adopted) by the relevant standard setter without regarding strict conformity with each and every disclosure. This assessment should be based on the particular facts, including the similarities to and differences from the requirements of the relevant standard from which relief is provided. The concept of 'equivalence' is intended to be aligned to that described in section 401 of the CA 2006; *[FRS 100.AG8-9]* and
- disclosure exemptions for subsidiaries are permitted where the relevant disclosure requirements are met in the consolidated financial statements, even where the disclosures are made in aggregate or abbreviated form, or in relation to intra-group balances, those intra-group balances have been eliminated on consolidation. If, however, no disclosure is made in the consolidated financial statements on the grounds of materiality, the relevant disclosures should be made at the subsidiary level if material in those financial statements. *[FRS 100.AG10]*.

This means that a qualifying entity must review the consolidated financial statements of its parent to ensure that 'equivalent' disclosures have been made for each of the above exemptions that it intends to use. Where a particular 'equivalent' disclosure has not been made (unless the disclosure relates to an intra-group balance eliminated on consolidation) then the qualifying subsidiary cannot use the exemption in respect of that disclosure.

6.3 Disclosures required by the Regulations in the financial statements for certain financial instruments (and other assets) which may be held at fair value

Paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents in Schedule 2 and Schedule 3 to the Regulations and the LLP Regulations) state that financial instruments which under international accounting standards may be included in accounts at fair value, may be so included, provided that the disclosures required by such accounting standards are made. *[FRS 101 Appendix II.6]*. The reference to 'international accounting standards' in this context means EU-adopted IFRS.

The legal appendix to FRS 101 confirms that a qualifying entity that has financial instruments measured at fair value in accordance with the requirements of paragraph 36(4) of Schedule 1 to the Regulations (or its equivalents) is legally required to provide the relevant disclosures set out in extant EU-adopted IFRS. *[FRS 101 Appendix II.7]*. The most logical interpretation of this is that an entity should make all material disclosures required by IFRS 7 and IFRS 13 in respect of such instruments.

The financial instruments referred to by paragraph 36(4) of Schedule 1 of the Regulations (and its equivalents) are those listed in paragraphs 36(2)(c) and 36(3) of Schedule 1 to the Regulations (and its equivalents). These are: *[1 Sch 36]*

- any financial liability which is not held for trading or a derivative, i.e. a financial liability measured or designated at fair value through profit or loss (FVPL) under paragraphs 4.2.2, 4.3.5 or 4.3.6 of IFRS 9;
- loans and receivables originated by the reporting entity, not held for trading purposes, and measured or designated at either fair value through other comprehensive income (FVOCI) or FVPL under paragraphs 4.1.2A, 4.1.4 or 4.1.5 of IFRS 9;
- interests in subsidiary undertakings, associated undertakings and joint ventures accounted at FVOCI or FVPL under IFRS 9 via paragraphs 10, 11 or 11A of IAS 27 or paragraph 18 of IAS 28 – *Investments in Associates and Joint Ventures*;
- contracts for contingent consideration in a business combination measured at FVPL; or
- other financial instruments with such special characteristics that the instruments according to generally accepted accounting principles or practice, should be accounted for differently from other financial instruments.

In addition, qualifying entities that are preparing Companies Act accounts must provide the disclosures required by paragraph 55 of Schedule 1 to the Regulations (and its equivalents in Schedules 2 and 3 to the Regulations and the LLP Regulations) which set out requirements relating to financial instruments at fair value. *[FRS 100 Appendix II.7D]*. These disclosures relate to financial instruments and other assets held at fair value generally and not just to those financial instruments measured at fair value in accordance with paragraph 36(4) as discussed above. Disclosures are required of: *[1 Sch 55]*

- the significant assumptions underlying the valuation models and techniques used when determining the fair value of the instruments or other assets;
- for each category of financial instrument or other asset, the fair value of the assets and the changes in value included directly in the profit and loss account or credited to or debited from the fair value reserve in respect of those assets;
- for each class of derivatives, the extent and nature of the instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows; and
- where any amount is transferred to or from the fair value reserve during the financial year, disclosure (in tabular form) of the opening and closing balance of the reserve, the amount transferred to or from the reserve during the year and the source and application respectively of the amounts so transferred.

6.4 Disclosure exemptions for financial institutions

Financial institutions are permitted to apply FRS 101 but receive fewer disclosure exemptions. A qualifying entity which is a financial institution may take advantage in its individual financial statements of the disclosure exemptions set out at 6.1 above except for: *[FRS 101.7]*

- the disclosure exemptions from IFRS 7;
- the disclosure exemptions from paragraphs 91 to 99 of IFRS 13 to the extent that they apply to financial instruments. Therefore, a financial institution can take advantage of the disclosure exemptions from paragraphs 91 to 99 of IFRS 13 for assets and liabilities other than financial instruments (e.g. property plant and equipment, intangible assets, and investment property); and
- the capital disclosures of paragraphs 134 to 136 of IAS 1.

Entities which are subject to the CA 2006 and the Regulations or the LLP Regulations are legally required to provide disclosures related to financial instruments and assets and liabilities including those measured at fair value (see 6.3 above and 7.2 below).

The FRC has opted not to provide a generic definition of a financial institution. Instead, it has provided a list of entities that are stated to be financial institutions. A 'financial institution' is stated to be any of the following: *[FRS 101 Appendix I]*

(a) a bank which is:
    (i) a firm with a Part 4A permission (as defined in section 55A of the Financial Services and Markets Act 2000 or references to equivalent provisions of any successor legislation) which includes accepting deposits and:
        (a) which is a credit institution; or
        (b) whose Part 4A permission includes a requirement that it complies with the rules in the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment Firms relating to banks, but which is not a building society, a friendly society or a credit union;
    (ii) an EEA bank which is a full credit institution;

(b) a building society which is defined in section 119(1) of the Building Societies Act 1986 as a building society incorporated (or deemed to be incorporated) under that Act;

(c) a credit union, being a body corporate registered under the Co-operative and Community Benefit Societies Act 2014 as a credit union in accordance with the Credit Unions Act 1979, which is an authorised person;

(d) custodian bank or broker-dealer;

(e) an entity that undertakes the business of effecting or carrying out insurance contracts, including general and life assurance entities;

(f) an incorporated friendly society incorporated under the Friendly Societies Act 1992 or a registered friendly society registered under section 7(1)(a) of the Friendly Societies Act 1974 or any enactment which it replaced, including any registered branches;

(g) an investment trust, Irish investment company, venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC); or

(h) [deleted]

(i) any other entity whose principal activity is similar to those listed above but is not specifically included in that list.

    A parent entity whose sole activity is to hold investments in other group entities is not a financial institution.

The Triennial review 2017 removed stockbrokers (from item (d) above) and a retirement benefit plan (previously (h) above) from the list of entities considered to be a financial institution. In addition, (i) above was amended to remove the words highlighted in italics, 'any other entity whose principal activity is *to generate wealth or manage risk through financial instruments. This is intended to cover entities that have business activities* similar to those listed above but are not specifically included in the list above'. The purpose of this latter change was to help reduce interpretational difficulties and to reduce the number of entities meeting the definition of a financial institution. Accordingly, an entity which generated wealth or managed risk through financial instruments but which is not similar to those listed at (a) to (g) above is no longer to be a financial institution. *[FRS 101.BC19]*. These changes may be an incentive for some entities to early adopt the Triennial review 2017.

However, in some cases, judgement, based on the facts and circumstances, may be needed in assessing whether an entity's *principal activities* are similar to those listed at (a) to (g) above. For example, the Basis for Conclusions observes that judgement will need to be applied in determining whether a group treasury company is similar to the other entities listed in the definition of a financial institution. *[FRS 101.BC21]*.

7 ADDITIONAL COMPANIES ACT DISCLOSURES

FRS 101 individual financial statements (which are Companies Act accounts) are subject to disclosures required by the Regulations as well as other disclosures required by the Companies Act or other related regulations. These disclosures are in addition to those required by EU-adopted IFRS.

There are two types of Companies Act disclosures that are required for a UK entity applying FRS 101:

(a) those required for both IAS accounts (prepared under EU-adopted IFRS) and Companies Act accounts (prepared under a form of UK GAAP) (see 7.1 below); and

(b) those required by the Regulations for Companies Act accounts but not for IAS accounts (see 7.2 below).

This means that, in certain scenarios, a move from EU-adopted IFRS to FRS 101 would result in increased disclosures for an entity despite the use of the disclosure exemptions described at 6 above.

There may also be additional disclosures for an entity other than a company where that entity is subject to separate regulations.

7.1 Existing Companies Act disclosures in the financial statements for EU-adopted IFRS and UK GAAP reporters that also apply under FRS 101

FRS 100 identifies the following required disclosures: *[FRS 100 Appendix II.19]*

- section 410A – Off-balance sheet arrangements;
- section 411 – Employee numbers and costs;
- section 412 – Directors' benefits: remuneration;
- section 413 – Directors' benefits: advances, credit and guarantees;

- sections 414A to 414D – Strategic report;
- sections 415 to 419 – Directors' report;
- sections 420 to 421 – Directors' remuneration report; and
- section 494 – Services provided by auditor and associates and related remuneration.

The disclosures identified by FRS 100 above is incomplete and omits, for example, the information about related undertakings required by section 409. There are also certain disclosure exemptions for small companies and medium-sized companies (see Chapter 5 at 12 and Chapter 1 at 6.6.2).

LLPs are not subject to equivalent statutory requirements to those in sections 412 to 421 above although banking and insurance LLPs are required to prepare a strategic report for financial years beginning on or after 1 January 2017.

In addition, other Companies Act or related disclosures may apply depending on individual circumstances such as the disclosures required for a parent taking advantage of the exemption from preparing group accounts under either section 400 or section 401 of the CA 2006.

7.2 Disclosures required by the Regulations and the LLP Regulations in FRS 101 financial statements but not required under EU-adopted IFRS

The Regulations and the LLP Regulations require various disclosures in financial statements. In particular, Part 3 of Schedules 1 to 3 to the Regulations (and Part 3 of Schedule 1 to the LLP Regulations) require certain disclosures to be made in the notes to the financial statements if not given in the primary statements. The relevant paragraphs are as follows:

- Schedule 1 paragraphs 42 to 75;
- Schedule 2 paragraphs 52 to 92B;
- Schedule 3 paragraphs 60 to 90B; or
- the LLP Regulations paragraphs 42 to 70B.

Although some of these disclosure requirements are replicated in EU-adopted IFRS, others are not. Entities that move to FRS 101 from FRS 102 will have made these disclosures previously and therefore these requirements will not increase their reporting burden. Entities that move to FRS 101 from EU-adopted IFRS will not have made these disclosures previously or any other disclosures required by the applicable schedule above and should consider carefully the impact of these new requirements against the benefits of the reduced disclosures discussed at 6 above.

In addition, entities subject to the Regulations and LLP Regulations are required to present the notes to the financial statements in the order in which, where relevant, the items to which they relate are presented in the balance sheet and profit and loss accounts (see 5.2 above). The General Rules to the formats in the Regulations and LLP Regulations require that where an asset or liability relates to more than one item in the balance sheet, the relationship of such asset or liability to the relevant items must be disclosed either under those items or in the notes to the accounts (see 5.1 above). *[1 Sch 9A]*.

Some examples of disclosures not required under EU-adopted IFRS in individual or separate financial statements are shown below. The disclosures illustrated below are not intended to be an exhaustive list of additional disclosures required by the Regulations and LLP Regulations for entities applying FRS 101 that have previously reported under EU-adopted IFRS.

(a) Schedule 1 companies (i.e. companies other than banking and insurance companies):
- disclosures required for certain financial instruments which may be held at fair value (see 6.3 above); *[1 Sch 36]*
- a statement required by large companies that the accounts have been prepared in accordance with applicable accounting policies; *[1 Sch 45]*
- disclosures in respect of share capital and debentures including information about shares and debentures allotted and contingent rights to shares; *[1 Sch 47-50]*
- disclosure of the split of land between freehold and leasehold and the leasehold land between that held on a long lease and that held on a short lease; *[1 Sch 53]*
- disclosure of information about listed investments; *[1 Sch 54]*
- disclosure of information about the fair value of financial assets and liabilities, investment property, living animals and plant which, in substance, 'reinstates' some parts of IFRS 7 and IFRS 13. In particular, there are requirements to disclose significant assumptions underlying the valuation models and techniques used when determining fair value of the instruments, details of the fair value of financial instruments by category and details concerning significant terms and conditions of derivatives (see 6.3 above); *[1 Sch 55]*
- disclosure of information about creditors due after five years; *[1 Sch 61]*
- disclosure of information about guarantees and other financial commitments including charges on assets to secure liabilities, the particulars and total amount of any guarantees, contingencies and commitments not recorded in the balance sheet, the nature and form of valuable security given and separate disclosure of pension commitments and guarantees and commitments given to certain related entities; *[1 Sch 63]*
- disclosure of information about loans made in connection with the purchase of own shares; *[1 Sch 64]*
- disclosure of particulars of taxation; *[1 Sch 67]* and
- disclosure of information about turnover by class of business and geographical markets. IFRS 8 does not require segmental information if an entity's debt or equity instruments are not traded in a public market or the entity is not in the process of filing financial statements for that purpose. However, the disclosures in the Regulations are required even if the entity is out of scope of IFRS 8. See also 5.2.1 above. *[1 Sch 68]*.

The profit and loss account of a company that falls within section 408 of the CA 2006 (individual profit and loss account where group accounts prepared) need not contain the information specified in paragraphs 65 to 69 of Schedule 1. *[Regulations 3(2)]*.

(b) Schedule 2 companies (i.e. banking companies)

- a statement that the accounts have been prepared in accordance with applicable accounting policies; *[2 Sch 54]*
- disclosures in respect of share capital and debentures including information about shares and debentures allotted and contingent rights to shares; *[2 Sch 58-61]*
- disclosure of the split of land between freehold and leasehold and the leasehold land between that held on a long lease and that held on a short lease; *[2 Sch 64]*
- disclosure of a specific maturity analysis for loans and advances and liabilities; *[2 Sch 72]*
- disclosure of arrears of fixed cumulative dividends; *[2 Sch 75]*
- disclosure of information about guarantees and other financial commitments including charges on assets to secure liabilities, the particulars and total amount of any guarantees, contingencies and commitments not recorded in the balance sheet, the nature and form of valuable security given and separate disclosure of pension commitments and guarantees and commitments given to certain related entities; *[2 Sch 77]*
- disclosure of details of transferable securities; *[2 Sch 79]*
- disclosure of leasing transactions; *[2 Sch 80]*
- disclosure of assets and liabilities denominated in a currency other than the presentational currency; *[2 Sch 81]*
- disclosure of details of unmatured forward transactions; *[2 Sch 83]*
- disclosure of loans made in connection with the purchase of own shares; *[2 Sch 84]*
- disclosure of particulars of taxation; *[2 Sch 86]* and
- disclosure of certain profit and loss account information by geographical markets. IFRS 8 does not require segmental information if an entity's debt or equity instruments are not traded in a public market or the entity is not in the process of filing financial statements for that purpose. However, the disclosures in the Regulations are required even if the entity is out of scope of IFRS 8. *[2 Sch 87]*.

The profit and loss account of a banking company that falls within section 408 of the CA 2006 (individual profit and loss account where group accounts prepared) need not contain the information specified in paragraphs 85 to 91 of Schedule 2. *[Regulations 5(2)]*.

(c) Schedule 3 companies (i.e. insurance companies)

- a statement that the accounts have been prepared in accordance with applicable accounting policies; *[3 Sch 62]*
- disclosures in respect of share capital and debentures including information about shares and debentures allotted and contingent rights to shares; *[3 Sch 65-68]*
- disclosure of the split of land between freehold and leasehold and the leasehold land between that held on a long lease and that held on a short lease; *[3 Sch 71]*
- disclosure of information about listed investments; *[3 Sch 72]*
- disclosure of creditors due after five years; *[3 Sch 79]*
- disclosure of information about guarantees and other financial commitments including charges on assets to secure liabilities, the particulars and total amount of any guarantees, contingencies and commitments not recorded in the balance sheet, the nature and form of valuable security given and separate disclosure of pension commitments and guarantees and commitments given to certain related entities; *[3 Sch 81]*
- disclosure of loans made in connection with the purchase of own shares; *[3 Sch 82]*
- disclosure of particulars of taxation; *[3 Sch 84]*
- disclosure of certain profit and loss account information by type of business and by geographical area. IFRS 8 does not require segmental information if an entity's debt or equity instruments are not traded in a public market or the entity is not in the process of filing financial statements for that purpose. However, the disclosures in the Regulations are required even if the entity is out of scope of IFRS 8; *[3 Sch 85-87]* and
- disclosure of total commissions for direct insurance business. *[3 Sch 88]*.

The profit and loss account of an insurance company that falls within section 408 of the CA 2006 (individual profit and loss account where group accounts prepared) need not contain the information specified in paragraphs 83 to 89 of Schedule 3. *[Regulations 6(2)]*.

Banking and insurance companies are financial institutions (see 6.4 above) and therefore must comply with IFRS 7 disclosures in full and IFRS 13 disclosures in respect of financial instruments, including disclosures about the fair value of financial assets and liabilities.

(d) LLPs (i.e. entities subject to the LLP Regulations)

- a statement required by large companies that the accounts have been prepared in accordance with applicable accounting policies; *[1 Sch 45 (LLP)]*
- disclosures in respect of loans and debts due to members; *[1 Sch 47 (LLP)]*
- disclosures in respect of debentures; *[1 Sch 48 (LLP)]*
- disclosure of the split of land between freehold and leasehold and the leasehold land between that held on a long lease and that held on a short lease; *[1 Sch 51 (LLP)]*
- disclosure of information about listed investments; *[1 Sch 52 (LLP)]*

- disclosure of information about the fair value of financial assets and liabilities, stocks, investment property and living animals and plant where those assets and liabilities have been valued at fair value which, in substance, 'reinstates' some parts of IFRS 7 and IFRS 13. In particular, there are requirements to disclose information about significant assumptions where the fair value of a financial instrument results from generally accepted valuation models and techniques, details of the fair value of financial instruments by category and details concerning significant terms and conditions of derivatives (see 6.3 above); *[1 Sch 53 (LLP)]*
- disclosure of information about creditors due after five years; *[1 Sch 59 (LLP)]*
- disclosure of information about guarantees and other financial commitments including charges on assets to secure liabilities, the particulars and total amount of any guarantees, contingencies and commitments not recorded in the balance sheet, the nature and form of valuable security given and separate disclosure of pension commitments and guarantees and commitments given to certain related entities; *[1 Sch 60 (LLP)]*
- disclosure of particulars of taxation; *[1 Sch 64 (LLP)]*
- disclosure of information about turnover by class of business and geographical markets. IFRS 8 does not require segmental information if an entity's debt or equity instruments are not traded in a public market or the entity is not in the process of filing financial statements for that purpose; *[1 Sch 65 (LLP)]* and
- disclosure of particulars of members. *[1 Sch 66 (LLP)]*.

8. FUTURE CHANGES TO IFRS AND THEIR IMPACT ON FRS 101

Although not specifically addressed by FRS 101, future changes to EU-adopted IFRS would appear to be automatically incorporated into FRS 101 unless they are modified by the FRC.

The FRC reviews FRS 101 annually to ensure that the reduced disclosure framework continues to be effective in providing disclosure reductions for qualifying entities when compared with EU-adopted IFRS. *[FRS 101.BC10]*.

The principles established for FRS 101 is that the FRC aims to provide succinct financial reporting standards that: *[FRS 101.BC4]*

- have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
- balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;
- balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest and users' information needs;
- promote efficiency within groups; and
- are cost-effective to apply.

Whenever a new IFRS is issued or an amendment is made to an existing EU-adopted IFRS, the FRC has to consider the following on qualifying entities: *[FRS 101.BC7]*

- Relevance – does the disclosure requirement provide information that is capable of making a difference to the decisions made by users of the financial statements of a qualifying entity?
- Cost constraint on useful financial reporting – does the disclosure requirement impose costs on the preparers of the financial statements of a qualifying entity that are not justified by the benefits to the users of those financial statements?
- Avoid gold plating – Does the disclosure requirement override an existing exemption provide by company law in the UK?

8.1 IFRS 17 – *Insurance Contracts*

In May 2017, the IASB issued IFRS 17. As a result of the 2017/18 review cycle, it was concluded that a more detailed consideration of this standard is required but that this would be deferred until a clearer picture of the progress of the endorsement of the standard is known. Company law contains specific requirements for insurance companies, in terms of both the presentation and determination of provisions. IFRS 17 will need to be considered in more detail to determine whether there are any inconsistencies with company law, and if so what options might be available for addressing them. *[FRS 101.BC61A]*.

References

1 *True and Fair*, FRC, June 2014.

2 *The Financial Reporting Council: The True and Fair Requirement Revised – Opinion*, Martin Moore QC, May 2008, para. 4(F).

Chapter 3 Scope of FRS 102

Chapter 3 Scope of FRS 102

1 INTRODUCTION

Section 1 – *Scope* – of FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland* – sets out which entities can apply FRS 102. Its requirements are consistent with the general financial reporting framework set out in FRS 100 – *Application of Financial Reporting Requirements*, discussed further at 2.1 below. FRS 102 applies to financial statements intended to give a true and fair view. As its application is not restricted to UK and Irish companies, all entities should ensure that preparation of their financial statements in accordance with FRS 102 is permitted by the legal framework in which they operate. The legal framework for UK companies is discussed in more detail in Chapter 1 at 6.

This chapter covers the following topics:

- summary (see 1.1 below);
- development of FRS 102 and its ongoing review (see 1.2 below);
- effective date of FRS 102 (and FRS 103) (see 1.3 below);
- structure of FRS 102 (see 1.4 below);
- scope of FRS 102 (see 2 below);
- reduced disclosure framework (available to qualifying entities in their individual financial statements) (see 3 below); and
- Companies Act 2006 ('CA 2006') requirements including the exemptions available for small and medium-sized companies and LLPs (see 4 below).

Except where otherwise stated, the rest of this chapter will refer to the requirements for UK companies and LLPs, and refers to UK GAAP (prior to implementation of FRS 100 to FRS 103) as 'previous UK GAAP'.

FRS 103 – *Insurance Contracts – Consolidated accounting and reporting requirements for entities in the UK and Republic of Ireland issuing insurance contracts* (see 1.2.4 below and Chapter 33) applies to financial statements prepared in accordance with FRS 102 by entities that issue insurance contracts (including reinsurance contracts), hold reinsurance contracts or issue financial instruments (other than insurance contracts) with discretionary participation features. *[FRS 103.1.1-1.3, FRS 102.1.6]*.

FRS 104 – *Interim Financial Reporting* – is a voluntary standard that FRS 102 reporters can apply in preparing interim financial statements. This is discussed at 1.2.5 below and Chapter 34.

1.1 Summary

This summary covers a number of areas relevant to the scope of FRS 102 and to its structure which are addressed more fully in the chapter, as indicated.

- Adoption of FRS 102 is voluntary – the standard applies to the financial statements of entities preparing financial statements in accordance with legislation, regulation or accounting standards applicable in the UK and the Republic of Ireland that are *not* prepared in accordance with EU-adopted IFRS, FRS 101 – *Reduced Disclosure Framework* – or FRS 105 – *The Financial Reporting Standard applicable to the Micro-entities Regime*. See 2.1 below.
- FRS 102 does not set out which entities must prepare financial statements; this is governed by the legal framework (or other regulation or requirements), if any, relating to the preparation of the entity's financial statements. For example, statutory accounts prepared in accordance with FRS 102 by a UK company are Companies Act accounts. While FRS 102 has been developed with the requirements for Companies Act accounts primarily in mind, the standard is available for adoption by entities other than UK companies, including non-UK entities. An entity applying FRS 102 must ensure that it complies with any applicable legal requirements. See 2.1 below.
- FRS 102 was originally issued in March 2013, and subsequently amended several times. All amendments are listed at 1.2 below and the effective date of the March 2018 version of the standard is addressed at 1.3 below.
- FRS 102 applies to general purpose financial statements of entities, including public benefit entities (see 2.5.2 below) that are intended to give a true and fair view. FRS 102 can be applied in consolidated and/or individual financial statements.
- FRS 102 is a single financial reporting standard based on the IFRS for SMEs, which itself generally includes simplified requirements and disclosures compared to full IFRSs. A number of modifications have been made to FRS 102 compared to the IFRS for SMEs (see 1.2 below). While largely based on IFRSs, FRS 102 is not just a simplified version of IFRSs. In certain cases, the standard includes direct references to IFRSs.
- Since FRS 102 includes less guidance than IFRSs, judgement is likely to be required in applying the standard. Section 10 – *Accounting Policies, Estimates and Errors* – sets out a 'GAAP hierarchy' that management should refer to in developing and applying relevant and reliable accounting policies where the standard does not specifically address the issue. This hierarchy includes references to applicable SORPs. Certain SORPs have been updated to comply with FRS 102, whereas others have been withdrawn on implementation of FRS 102. See 2.3 below. In addition, management may but is not required to refer to IFRSs addressing similar and related issues.

- FRS 102 requires certain types of entities to directly apply particular IFRSs, namely IAS 33 – *Earnings per Share*, IFRS 6 – *Exploration for and Evaluation of Mineral Resources* – and IFRS 8 – *Operating Segments*. These standards apply to FRS 102 reporters that would fall within the scope of these standards if applying IFRS. See 2.4 below.
- In addition, an entity applying FRS 102 has a choice of applying the recognition and measurement requirements for financial instruments in:
  - Section 11 – *Basic Financial Instruments* – and Section 12 – *Other Financial Instruments Issues* – of FRS 102;
  - IAS 39 – *Financial Instruments: Recognition and Measurement* (the version extant immediately prior to IFRS 9 – *Financial Instruments* – superseding IAS 39); or
  - IFRS 9 and IAS 39 (as amended by IFRS 9).

  Whatever policy choice for the recognition and measurement of financial instruments is followed, FRS 102 reporters must give the disclosures required by Sections 11 and 12 and follow the presentation requirements (on offset of financial assets and financial liabilities) in these sections, rather than those required by IFRSs. See Chapter 10 at 4.
- FRS 102 requires an entity to apply FRS 103 to insurance contracts (including reinsurance contracts) that it issues and reinsurance contracts that it holds, and financial instruments (other than insurance contracts) with a discretionary participation feature that it issues. See 1.2.4 below.
- Since statutory accounts prepared by UK companies in accordance with FRS 102 are Companies Act accounts, these must comply with the requirements of the CA 2006 and of *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (SI 2008/410) ('the Regulations') or *The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008* (SI 2008/409) ('the Small Companies Regulations').

  Statutory accounts prepared by LLPs in accordance with FRS 102 are non-IAS accounts and must comply with similar requirements under LLP law.

  The CA 2006 and the relevant regulations set out the formats for the balance sheet and profit and loss account (see Chapter 6 at 4 to 6), recognition and measurement principles and further disclosures required in Companies Act accounts (or non-IAS accounts, for an LLP). Entities not subject to the Regulations (or LLP Regulations) must also use the statutory or, where permitted, adapted formats for the balance sheet and profit and loss account, set out in those regulations except to the extent that these requirements are not permitted by any statutory framework under which such entities report.

  While FRS 102 (and Appendix III – *Note on Legal Requirements* – to the standard) highlight certain issues relevant to Companies Act accounts, the discussion is not comprehensive. See 4 below, Chapter 1 at 6 and Chapter 6 at 9 and 10.
- Section 34 – *Specialised Activities* – sets out specific accounting and disclosure requirements for agriculture, extractive activities, service concession arrangements, financial institutions, retirement benefit plans, heritage assets, funding commitments,

and certain issues specific to public benefit entities. Paragraphs marked PBE throughout the standard are specific to public benefit entities, and not for general application. See 2.5 below.

Section 34, in particular, sets out additional disclosure requirements for the financial statements of a financial institution (and for the consolidated financial statements of a group containing a financial institution) and for the financial statements of a retirement benefit plan. The definition of a 'financial institution' and the required disclosures are discussed at 2.5.1 below.

- FRS 102 includes a reduced disclosure framework for qualifying entities, available in their individual financial statements only, where the criteria are met. The FRC withdrew the requirement for shareholder notification in December 2016 with immediate effect.

  A qualifying entity is a member of a group that is consolidated in publicly available consolidated financial statements of the parent of that group which are intended to give a true and fair view. Some of the disclosure exemptions available under the reduced disclosure framework are conditional on equivalent disclosures being included in the consolidated financial statements of the group in which the entity is consolidated. In addition, a financial institution has fewer exemptions than an entity that is not a financial institution. See 3 below.
- Section 35 – *Transition to this FRS* – addresses transition to FRS 102. Section 35 is based on a simplified version of IFRS 1 – *First-time Adoption of International Financial Reporting Standards*, but with significant modifications. See Chapter 32.

1.2 Development of FRS 102

FRED 44 – *Financial Reporting Standard for Medium-sized Entities*, published in 2010, proposed that the standard, based on the IFRS for SMEs, would apply to entities that did not have public accountability. Under the proposals, entities that did have public accountability would have been required to apply EU-adopted IFRS. However, respondents were not supportive of the extension of the application of EU-adopted IFRS, and the former ASB decided to amend the IFRS for SMEs so that it is relevant to a broader group of preparers and users. *[FRS 102 Overview (v)]*. See 1.2.1 below.

In developing the framework, the FRC set out an overriding objective to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. *[FRS 102 Overview (i)]*. See Chapter 1 at 4.

The Accounting Standards Board (replaced by the FRC in 2012) decided IFRS for SMEs would be used as a basis for the development of FRS 102, noting that it was a way of achieving a consistent accounting framework (as a simplification of IFRSs), reflected more up-to-date thinking and developments than previous UK GAAP, was a single standard setting out clear accounting requirements, and was a cost effective way of updating previous UK GAAP. *[FRS 102.BC.A.4]*.

To be consistent with objective of providing succinct financial reporting standards, certain UITF Abstracts were incorporated into FRS 102, namely UITF – Abstract 4 *Presentation of long-term debtors in current assets,* UITF Abstract 31 – *Exchange of* *businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associate*, UITF Abstract 32 – *Employee benefit trusts and other intermediate payment arrangements* and UITF Abstract 43 – *The Interpretation of equivalence for the purposes of section 228A of the Companies Act 1985*. *[FRS 102.BC.A.9]*.

Initially a three tier system, using public accountability as a differentiator, was mooted, but concerns were expressed about this and therefore public accountability was eliminated as a differentiator. As a result, FRS 102 is applicable to all entities which are not required to apply EU-adopted IFRS. Consequently various entities which are outside the scope of IFRS for SMEs are in the scope of FRS 102 and additional requirements have been developed for financial institutions, public benefit entities and entities whose debt or equity instruments are publicly traded, but not on a regulated market. *[FRS 102.BC.A.11-13]*. Requirements which conflicted with company law were simultaneously removed from FRS 102 and it was concluded that all entities applying FRS 102 would be required to follow company law formats to promote consistency. *[FRS 102.BC.A.14-15]*.

FRS 102 was published in March 2013. Subsequently, the following amendments to FRS 102 have been issued:

- Amendments to FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland – Basic Financial Instruments and Hedge Accounting* (July 2014);
- Amendments to FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland – Pension Obligations* (February 2015);
- Amendments to FRS 102 –*The Financial Reporting Standard applicable in the UK and Republic of Ireland – Small Entities and other minor amendments* (July 2015);
- Amendments to FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland – Fair value hierarchy disclosures* (March 2016);
- Amendments to FRS 101 – *Reduced Disclosure Framework* and FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland – Notification of shareholders* (December 2016) (see 1.2.3.A below);
- Amendments to FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland – Directors' loans – optional interim relief for small entities* (May 2017) (see 1.2.3.B below);
- Amendments to FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland – Triennial Review 2017 – Incremental Improvements and Clarifications* (December 2017). (Triennial review 2017) (see 1.2.3.C below).

All of the above amendments are now incorporated in the March 2018 version of the standard. The FRC has issued the following subsequent versions of the standard:

- 'the August 2014 version' of FRS 102, which includes the original standard and the July 2014 amendments (note that this version does not include all amendments effective for accounting periods beginning on or after 1 January 2015);
- 'the September 2015 version' of FRS 102, which incorporates the July 2015 and all earlier amendments made to the standard; and
- 'the March 2018 version' of FRS 102 (which is effective for accounting periods beginning on or after 1 January 2019) and includes all amendments from March 2016 onwards, including the amendments introduced in the Triennial review 2017.

FRS 103 and FRS 104, which are applicable to certain entities applying FRS 102, are discussed respectively at 1.2.4 and 1.2.5 below.

See 1.3 below for the effective dates of the amendments to FRS 102 and FRS 103.

1.2.1 Amendments made in FRS 102 compared to the IFRS for SMEs

The Accounting Standards Board (replaced by the FRC in 2012), replying to concerns from respondents about the removal of certain accounting policy options and noting that some pragmatism was required in determining what amendments were to be made to the IFRS for SMEs, developed a set of guidelines for application in the UK and Republic of Ireland (ROI). *[FRS 102.BC.A.5-6]*.

The guidelines were as follows:

- Changes should be made to permit accounting treatments that existed in FRSs at the transition date which align with EU-adopted IFRS.
- Changes should be consistent with EU-adopted IFRS unless a non-IFRS based solution clearly better meets the objective of providing high-quality understandable financial reporting proportionate to the size and complexity of the entity and the users' information needs. In these cases, elements of an IFRS-based solution may nevertheless be retained.
- Use should be made, where possible, of existing exemptions in company law to avoid gold-plating.
- Changes should be made to provide clarification, by reference to EU-adopted IFRS, which would avoid unnecessary diversity in practice. *[FRS 102.BC.A.6]*.

As a result of applying the guidelines, FRS 102 now includes accounting options for the capitalisation of borrowing costs, the revaluation of property, plant and equipment and intangible assets and, in certain circumstances, the capitalisation of development costs. *[FRS 102.BC.A.7]*.

Further clarifications were also made, some by reference to EU-adopted IFRS and some to previous UK and Ireland accounting standards. Examples of these include: *[FRS 102.BC.A.8]*

- Amending the disclosure requirements for discontinued operations for compliance with company law.
- Providing an option to use cost or fair value for the measurement of investments by an investor which is not a parent, but has an investment in one or more associates and/or jointly controlled entities.
- Clarifying that the life of goodwill cannot exceed 10 years, where the entity is otherwise unable to make a reliable estimate – this also applies to intangible assets. Previously the time period was 5 years, but this was changed subsequent to the implementation of the EU Accounting Directive in 2015.
- Clarifying the accounting treatment of group share-based payments when the award is granted by the parent or another group entity.

Subsequent amendments made to FRS 102 have continued to follow the guidelines set out above. The Triennial review 2017 represents the most significant revision of FRS 102 to date and has been carried out in response to stakeholder feedback on the implementation of FRS 102 and after considering recent improvements in financial reporting.

1.2.2 Review of FRS 102

1.2.2.A Triennial review 2017

When FRS 102 was first issued, the FRC indicated that the standard would be reviewed every three years, in response to feedback from stakeholders on areas for improvement and to areas identified by the FRC. The review process was seen as an opportunity to look at the implementation of FRS 102 and whether it had achieved its aims, as well as an opportunity to make improvements. Sources of potential improvements used included feedback from stakeholders on possible areas of improvement, areas identified by the FRC for review, the IASB's 2015 *Amendments to the IFRS for SMEs* and changes in IFRS (both new IFRS, amendments to existing IFRS and new interpretations). Feedback from stakeholders was gathered through a request for information, a consultation document on the approach to changes in IFRS and exposure drafts setting out the proposed amendments. While amendments to IFRS for SMEs remained a useful source for considering the development of FRS 102, the wider scope of FRS 102 meant that the FRC also reviewed changes in IFRS, as it was seeking an overall IFRS-based solution. *[FRS 102.BC.A.33-35]*.

In December 2017, the FRC published the amendments resulting from the first of these triennial reviews as Triennial review 2017 and in March 2018 it issued the standard, incorporating all the amendments made in the Triennial review 2017. The main changes required by the Triennial review 2017 are set out below at 1.2.3.C below.

1.2.2.B Periodic review

In the Basis for Conclusions, it is noted that FRS 102 will continue to be subject to periodic review, likely every four to five years, rather than the three year cycle originally envisaged. The reason for the change in time frame is to allow time for experience of the most recent version to emerge before seeking stakeholder feedback. Such periodic reviews will consider stakeholder feedback, minor changes in IFRS, the IFRS for SMEs and other issues. However, the FRC will continue to assess emerging issues as they arise and therefore it is possible that there will be amendments issued outside the regular review cycle. *[FRS 102.BC.A.45]*.

At the time of writing, there is no timetable for bringing the requirements of IFRS 9, IFRS 15 – *Revenue from Contracts with Customers* – and IFRS 16 – *Leases* – into FRS 102. The FRC's current intention is to consider major changes to IFRS on a case-by-case basis and to monitor any implementation issues arising over an unspecified period of time: only at the end of that period would a consultation process begin. *[FRS 102.BC.A.44]*.

1.2.3 Amendments made to FRS 102 from December 2016

All amendments up to and including the Triennial review 2017 have been incorporated in the 2018 version of the standard. All amendments since December 2016 are discussed at 1.2.3.A to 1.2.3.C below.

1.2.3.A Amendments to FRS 101 Reduced Disclosure Framework and FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Notification of shareholders

The notification of shareholders amendment was issued in December 2016 and was applicable to both FRS 101 and FRS 102 reporters. *[FRS 102.BC.B1.3]*. The amendment removed the need to notify shareholders in writing about a qualifying entity's intention to use the disclosure exemptions; this requirement had originally been introduced to protect minority shareholders, by giving them an opportunity to object to the use of reduced disclosures. This opportunity has now been removed and it is considered by the FRC that sufficient information will continue to exist for minority shareholders to understand the effects of the reduced disclosure framework. *[FRS 102.BC.B1.4]*. The amendment was applicable to all accounting periods beginning or after 1 January 2016 and therefore had immediate effect on its publication. It was made after concerns were raised about the cost-effectiveness of requiring the notification of shareholders and uncertainty about how frequently such notification should be given. The lack of guidance on the latter point led to diversity in practice.

The FRC therefore concluded that a specific right to object to the use of the disclosure exemptions was not necessary given the information already available to shareholders and their existing rights. *[FRS 102.BC.B1.6]*.

1.2.3.B Amendment to FRS 102 (May 2017): Directors' loans – optional interim relief for small entities

This amendment was issued with immediate effect in May 2017 and could be applied retrospectively. It inserted paragraph 1.15A into Section 1 to permit a small entity to measure a basic financial liability, which is a loan from a director (a natural person), who is also a shareholder in the small entity (or a close member of the family of that person) initially at the transaction price and subsequently to carry it at amortised cost, even if it is a financing transaction. This amendment was removed from Section 1 in the Triennial review 2017 and the same concession was inserted into paragraph 13A of Section 11 (see Chapter 10).

1.2.3.C The Triennial review 2017

The Triennial review 2017 is the first comprehensive review of FRS 102 since its introduction in 2013. The amendments have been developed in response to stakeholder feedback and to recent developments in financial reporting; they therefore address many of the implementation issues reported by preparers to the FRC. The aim of the changes is to make the standard clearer and easier to use, by simplifying some accounting policies and introducing additional choices and exemptions, while maintaining cost effective financial reporting. The major changes introduced by the review are listed below, with references to where they are discussed in more detail in other chapters.

- Removal of the undue cost or effort exemptions from all sections.
- For an entity leasing an investment property to another group entity, an accounting policy choice has been introduced to permit the property to be treated as property, plant and equipment under Section 17, rather than being accounted for at fair value through profit or loss (see Chapter 14 at 3.1.2).
- The introduction of a description of a basic financial instrument to support the detailed conditions for classification as basic. If a financial instrument does not meet the conditions set out in paragraph 9 of Section 11, it may apply the general principle in paragraph 9A of Section 11, whereby a financial instrument may still be classified as basic if it gives rise to cash flows on specified dates that constitute the repayment of the principal advanced, together with reasonable compensation for

the time value of money, credit risk and other basic lending risks and costs. The intention of this amendment is to permit a small number of financial instruments, which previously breached the conditions to be classified as basic, to be now classified as basic. In particular, the FRC considered that this would assist with the classification of social housing loans with two-way compensation clauses as a basic financial instrument (see Chapter 10 at 6.1.2.E). *[FRS 102.BC.B11.16-18]*.

- For small entities, the ability to measure a loan from a director who is also a shareholder at its transaction price and subsequently at amortised cost, even if it is a financing transaction– see 1.2.3.B above.
- Entities will be required to recognise fewer intangible assets separately from goodwill in a business combination, thus reducing the cost of compliance. Entities may choose to recognise additional intangible assets meeting the recognition criteria if that would provide more useful information to the users of the financial statements. If the latter is adopted as an accounting policy, it must be consistently applied to the relevant class of intangible assets (see Chapter 16 at 2.1)
- The definition of a financial institution has been amended to remove references to 'generate wealth' and 'manage risk'. This change is intended both to reduce the number or entities meeting the definition of a financial institution and to assist with interpretational difficulties in applying the definition. Retirement benefit plans and stockbrokers have also been removed from the definition (see 2.5.1.A below).

1.2.4 FRS 103 – Insurance Contracts

FRS 103 (and its accompanying Implementation Guidance) consolidated existing financial reporting requirements for entities in the UK and Republic of Ireland issuing insurance contracts. It replaced the previous requirements in FRS 27 – *Life Assurance* – and the ABI SORP – *Statement of Recommended Practice on Accounting for Insurance Business*, which were withdrawn for accounting periods beginning on or after 1 January 2015. *[FRS 103.1.13]*. *Amendments to FRS 103 – Solvency II* – was issued in May 2016 and the standard was included in the scope of the Triennial review 2017. FRS 103 is discussed in Chapter 33.

1.2.5 FRS 104 – Interim Financial Reporting

FRS 102 does not address the presentation of interim financial reports. Entities preparing such reports must describe the basis for preparing and presenting such information. The original version of FRS 104 was issued by the FRC in November 2014 and set out a basis for the preparation and presentation of interim financial reports that an entity may apply. *[FRS 102.3.25]*. This standard was also included in the scope of the Triennial review 2017 and consequential amendments were made; the latest version of the standard was issued in March 2018. FRS 104 is discussed in Chapter 34.

1.3 Effective date of FRS 102 (and FRS 103)

For accounting periods beginning on or after 1 January 2019, there is one version of FRS 102 applicable to preparers. However, for accounting periods beginning before this date there are a number of amendments to the then extant September 2015 version and these are listed below at 1.3.2.

1.3.1 Accounting periods beginning on or after 1 January 2019

For accounting periods beginning on or after 1 January 2019, the following apply:

- the March 2018 version of FRS 102, containing the Triennial review 2017 amendments;
- the March 2018 version of FRS 103 (if an entity is in scope of FRS 103); and
- the March 2018 version of FRS 104 (if an entity is applying this standard to its interim reporting).

FRS 100 (March 2018) must be applied from the same date that the March 2018 version of FRS 102 is applied.

1.3.2 Accounting periods beginning before 1 January 2019

For accounting periods beginning before 1 January 2019, entities have a choice of (a) applying the March 2018 version of the standard early (see 1.3.1 above) or (b) applying the September 2015 version, in conjunction with the amendments issued in 2016 and 2017. If (b) is chosen, the following apply:

- the September 2015 version of FRS 102 (see 1.2 above);
- the February 2017 version of FRS 103 (if an entity is in scope of FRS 103) and the accompanying implementation guidance and clarification on Solvency II (see 1.2.4 above); *[FRS 103.1.11A]*
- the March 2015 version of FRS 104 (if an entity is applying this standard to its interim reporting);
- the March 2016 amendment to FRS 102; *[FRS 102.1.16]*
- the December 2016 amendment to FRS 102 (see 1.2.3.A above); and
- the May 2017 amendment to FRS 102 (see 1.2.3.B above).

Early application of the March 2018 version of FRS 102 is permitted, provided that all the amendments to the FRS are applied at the same time – in other words, cherry picking is not permitted. If an entity does early adopt the Triennial review 2017 amendments, it must disclose that fact. A small entity is not obliged to disclose that it has early adopted the amendments, but it is encouraged to make the disclosure. *[FRS 102.1.18]*.

There are three exceptions to the above, where amendments may be applied early without early application of the rest of the Triennial review 2017 amendments. The first relates to directors' loans (see 1.2.3.B above). The second relates to gift aid payments made within charitable groups; this early application was permitted following feedback from respondents.

The third exception relates to small entities in the Republic of Ireland only. For these entities, the Triennial review 2017 amendments to Section 1A are effective for accounting periods beginning on or after 1 January 2017, in order to align the effective date with the implementation of the Companies (Accounting) Act 2017. These amendments can also be early adopted and a small entity so adopting is encouraged, though not required, to disclose that fact. *[FRS 102.1.18]*. Such an entity must disclose that its financial statements have been prepared in accordance with Section 1A of FRS 102 and the effect of and reasons for any material departure from that section must also be disclosed. *[FRS 102.1AD.3]*.

1.3.3 Effective date – entities subject to SORP

Following the issuance of FRS 102, some SORPs have been updated for consistency with the original version of FRS 102 and others withdrawn. See Chapter 1 at 4.7.1 for a list of the extant SORPs. However, some SORPS have not been updated and there remains inconsistency in updating SORPS for subsequent amendments to FRS 102, leading to a lag between revisions to FRS 102 and the update of SORPs.

Amendments to the relevant SORPs are not necessary before any changes to FRS 102 take effect because a change in accounting standards after a SORP has been issued means any conflicting provisions of a SORP cease to have effect. *[FRS 100.6]*. However, where there is a lag between amendments made to FRS 102 and review of a SORP, there may be uncertainty as to which parts of a SORP are considered in conflict with the amended version of FRS 102 and over what, if any, changes to a SORP may subsequently be made. Consequently, an entity may be wary of early applying amendments to FRS 102 until the relevant SORP (which will generally include additional guidance and disclosures) has been reviewed. For example, it is generally understood that small charities may not adopt Section 1A of FRS 102. The *Charities SORP (FRS 102)* (as amended by Update Bulletin 2 in 2018) also includes additional disclosures for charities beyond those required by FRS 102, which would apply to small charities (unless specifically exempted by the SORP). See Chapter 5 at 4.2.

Certain entities may also be subject to legal requirements relating to the application of SORPs which may restrict the ability of an entity to early apply an amendment to FRS 102 (or related SORP). This issue may affect some charities but could also affect other entities not discussed below. It is therefore always important for entities to understand the legislative or other regulatory requirements governing the preparation of their financial statements.

1.3.3.A Charities

The legal framework for charities differs in England and Wales, Scotland, Northern Ireland and the Republic of Ireland and differs for unincorporated charities and charitable companies. It is beyond the scope of this publication to address the requirements for annual accounts and reports of charities and therefore this section only contains a brief overview of SORPs which may be applicable.

For entities with an accounting period beginning on or after 1 January 2019, the *Charities SORP (FRS 102)* should be applied in conjunction with Update Bulletin 2, which brings into the Charities SORP the Triennial review 2017 amendments. Except where prohibited by regulations or charity or company law, early application of the amendments to the SORP are permitted, provided that all of the amendments are applied at the same time.

1.4 Structure of FRS 102

FRS 102 includes Section 1 which addresses the scope of FRS 102, Section 1A – *Small Entities*, Section 2 – *Concepts and Pervasive Principles*, Sections 3 to 33 each addressing a separate accounting topic, Section 34 on specialised activities (see 2.5 below) and Section 35 on transition to FRS 102.

All paragraphs have equal authority. Some sections include appendices of implementation guidance or examples. Some of these are an integral part of FRS 102 whereas others provide guidance, but each specifies its status. Terms defined in the Glossary (included in Appendix I to FRS 102) are in bold type the first time they appear in each section of FRS 102 and in each sub-section of Section 34. *[FRS 102 Overview (vi)-(vii)].*

Appendix II *Table of equivalence for company law terminology* compares company law terminology with that used in FRS 102 and Appendix III *Note on legal requirements* provides an overview of how the requirements in FRS 102 address the requirements of the CA 2006 (Appendix IV – *Republic of Ireland Legal References* – addresses Irish law).

The Basis for Conclusions summarises the main issues considered by the FRC in developing FRS 102.

Section 1 of FRS 102 is addressed in this chapter.

2 SCOPE OF FRS 102

FRS 102 applies to financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period. *[FRS 102.1.1].*

FRS 102 is designed to apply to general purpose financial statements and to the financial reporting of entities including those that are not constituted as companies and those that are not profit-oriented, i.e. to financial statements which are intended to focus on the common information needs of a wide range of users (such as shareholders, lenders, other creditors, employees and members of the public). *[FRS 102 Overview (v)].*

FRS 102 applies to public benefit entities (PBEs) and other entities, not just to companies. *[FRS 102.1.2].* Paragraph numbers prefixed with a 'PBE' are applicable to public benefit entities, and are not applied directly or by analogy to entities that are not public benefit entities (other than, where specifically directed, entities within a public benefit entity group). *[FRS 102.1.2].* A public benefit entity must apply all paragraphs prefixed with a 'PBE' to the extent that they are relevant, provided that any SORP relating to that public benefit entity permits it. These paragraphs are generally found in Section 34 but are not restricted to that section. See 2.5.2 below.

An entity applying FRS 102 must ensure it complies with any relevant legal requirements applicable to it. FRS 102 does not necessarily contain all legal disclosure requirements. Section 1A includes most legal disclosures for small companies but, for example, those only relevant when the financial statements have been audited are not included. *[FRS 102.1.2A].* See Chapter 5 at 11 for disclosures required for small companies (and LLPs), including disclosures omitted by Section 1A.

2.1 Basis of preparation of financial statements

FRS 100 sets out the applicable financial reporting framework for entities preparing financial statements intended to give a true and fair view in accordance with legislation, regulations or accounting standards applicable in the UK and the Republic of Ireland. *[FRS 100.1-2].*

As stated in FRS 100, an entity required by the IAS Regulation (or other legislation or regulation) to prepare consolidated financial statements in accordance with EU-adopted IFRS must do so.

The individual financial statements of such an entity, or the individual financial statements or consolidated financial statements of any other entity within the scope of FRS 100, must be prepared in accordance with the following requirements:

(a) if the financial statements are the individual financial statements of an entity that is eligible to apply FRS 105 (and the entity chooses to do so), FRS 105; or

(b) if the financial statements are those of an entity that is not eligible to (or is eligible to but chooses not to) apply FRS 105, the financial statements must be prepared in accordance with:

  (i) FRS 102; or

  (ii) EU-adopted IFRS; or

  (iii) FRS 101 (if the financial statements are individual financial statements of a qualifying entity) (see Chapter 2). *[FRS 100.4, FRS 102.1.3]*.

The above requirements in Section 1 largely reinforce and are consistent with the general requirements on basis of preparation of financial statements in FRS 100. However, FRS 100 sets out the choices available slightly differently to Section 1 (see Chapter 1 at 4.4). FRS 100 states that the choice in (a) and (b) above relates to financial statements (whether consolidated financial statements *or* individual financial statements) that are not required by the IAS Regulation (or other legislation or regulation) to be prepared in accordance with EU-adopted IFRS. *[FRS 100.4]*. While the IAS Regulation does not require individual financial statements of UK companies with securities admitted to trading on a regulated market to be prepared in accordance with EU-adopted IFRS, some UK companies may be subject to other regulations that do require EU-adopted IFRS in individual financial statements.

FRS 105 can be applied by a UK company, qualifying partnership, or LLP that meets the eligibility conditions to apply the micro-entity provisions and is not excluded. See Chapter 1 at 4.4.6 and 6.2.2.B.

FRS 102 can also be used by entities that are not subject to the CA 2006 (or the Companies Act 2014 in the Republic of Ireland). An entity's choice of financial reporting framework must be permitted by the legal framework or other regulations or requirements that govern the preparation of the entity's financial statements. Other agreements or arrangements (such as shareholders' agreements or banking agreements) may restrict the choice of financial reporting framework.

The basis of preparation of financial statements in the UK is addressed in more detail in Chapter 1 at 4.4.

The requirements of the CA 2006 (and certain other regulatory rules) governing preparation of financial statements by UK companies are discussed in Chapter 1 at 6. The CA 2006 exemptions available to small companies, small LLPs and small qualifying partnerships are addressed in Chapter 5 at 13, which explains how FRS 102 interacts with the CA 2006 exemptions for small and medium-sized companies, LLPs and qualifying partnerships, where Section 1A is *not* applied.

2.2 Small entities

Small entities (as defined in Chapter 5 at 4.1) are entitled to apply Section 1A of FRS 102.

Small entities applying Section 1A follow the same recognition and measurement principles as full FRS 102 but the presentation and disclosure requirements in Section 1A, which are based on the statutory requirements applicable to companies subject to the small companies regime (and LLPs subject to the small LLPs regime) and are somewhat lighter than those that apply in full FRS 102. See Chapter 5 for a full discussion of the requirements of Section 1A.

A small entity, whether or not applying Section 1A, also benefits from:

- exemption from the preparation of a cash flow statement (see Chapter 7 at 3.1); and
- exemption from the preparation of consolidated financial statements (see Chapter 8 at 3.1.1.D).

2.3 Application of SORPs

SORPs recommend accounting practices for specialised industries or sectors, and supplement accounting standards and other legal and regulatory requirements in light of the special factors prevailing or transactions undertaken in a particular industry or sector. *[FRS 102 Appendix I]*.

FRS 102 makes reference to current SORPs (to the extent the provisions are in effect) as part of the hierarchy for management to consider when developing and applying accounting policies. *[FRS 102.10.5]*. See Chapter 9 at 3.2.

The provisions of a SORP cease to apply, for instance, where they conflict with a more recent financial reporting standard. *[FRS 100.6]*. See 1.3.3 above.

Individual SORPs should be referred to in order to understand the circumstances in which they apply. If a SORP does apply, the entity should state in its financial statements the title of the SORP and whether the financial statements have been prepared in accordance with the SORP's provisions that are currently in effect.

If the provisions of the SORP have been departed from, the entity should give a description of how the financial statements depart from the practice recommended by the SORP. In particular, for any treatment not in accordance with the SORP, the entity should disclose why the chosen treatment is judged more appropriate to the entity's circumstances and in the case of any omitted disclosures recommended by the SORP, the reason for the omission. A small entity applying the small entities regime in FRS 102 is exempt from this requirement, but such an entity is encouraged to provide the disclosures. *[FRS 102.1.7A, FRS 100.6]*.

2.4 Extension of specific IFRSs to certain types of entities

As FRS 102 is accessible to a wider scope of entities than the IFRS for SMEs, the FRC has extended its requirements (compared to the IFRS for SMEs) to address specific issues by way of direct references to IFRSs (as adopted by the EU). These IFRSs apply with the same scope as contained within the individual IFRS, as follows:

- IAS 33 – this standard applies to an entity whose ordinary shares or potential ordinary shares are publicly traded or that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market, or an entity that chooses to disclose earnings per share; *[FRS 102.1.4]*

- IFRS 6 – this standard applies to an entity that is engaged in the exploration for and/or evaluation of mineral resources (extractive activities); *[FRS 102.34.11]*
- IFRS 8 – this standard applies to an entity whose debt or equity instruments are publicly traded, or that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market, or an entity that chooses to provide information described as segment information. If an entity discloses disaggregated information, but that information does not comply with IFRS 8's requirements, the information shall not be described as segment information. *[FRS 102.1.5]*. See Chapter 6 at 3.3.2.

Chapter 3

References to other IFRSs made in IAS 33, IFRS 6 or IFRS 8 shall be taken to be references to the relevant section or paragraph made in FRS 102 (except that when applying paragraph 21 of IFRS 6, a cash generating unit or group of cash generating units shall be no larger than an operating segment (as defined in FRS 102's Glossary) and the reference to IFRS 8 shall be ignored). *[FRS 102.1.7, 34.11A-B]*.

2.4.1 Application of FRS 103

FRS 102 is not applicable to insurance contracts (including reinsurance contracts) issued or held by an entity, nor to financial instruments with a discretionary participation feature that an entity issues. Instead an entity must apply FRS 103 to such contracts and instruments. *[FRS 102.1.6, FRS 103.1.2]*. This is the same scope as for IFRS 4 – *Insurance Contracts* – and may be wider than entities that are legally insurers for legal or supervisory purposes. See 1.2.4 above and Chapter 33 for information on FRS 103.

2.5 Specialised activities

Section 34 of FRS 102 is devoted to additional requirements specific to specialised activities. These address:

- financial institutions (disclosures) (see 2.5.1 below);
- agriculture;
- extractive activities;
- service concession arrangements;
- heritage assets;
- funding commitments;
- incoming resources from non-exchange transactions;
- retirement benefit plans (accounting for retirement benefit plans and disclosures for such plans are not within the scope of this publication); and
- public benefit entities (see 2.5.2 below).

Importantly, Section 34 sets out requirements on certain areas not addressed directly by previous UK accounting standards or IFRSs. FRS 102's requirements on specialised activities are addressed in Chapter 31.

2.5.1 Financial institutions – disclosure requirements

A financial institution that is a qualifying entity is not entitled to make use of the disclosure exemptions from Sections 11 and 12 when applying the reduced disclosure framework in its individual financial statements (see 3 below). *[FRS 102.1.9]*.

Section 34 of FRS 102 includes additional disclosure requirements for financial institutions (see definition at 2.5.1.A below) in financial statements prepared in accordance with FRS 102.

These disclosure requirements set out in paragraphs 19 to 33 of Section 34 must be provided in: *[FRS 102.34.17]*

- the individual financial statements of a financial institution; and
- the consolidated financial statements of a group containing a financial institution where the financial institution's financial instruments are material to the group.

Disclosures are required in the consolidated financial statements of a group containing a financial institution even if the principal activities of the group itself are not being a financial institution. This has an implication for group accounts where a group company is identified as a financial institution (see 2.5.1.A below). Disclosures will be required in the group accounts in relation to financial instruments of the group company (to the extent the transactions have not eliminated on consolidation), where these are material to the group.

The additional disclosures required by financial institutions are set out in Chapter 10 at 11.2.4.

2.5.1.A Definition of a financial institution

The FRC has opted not to provide a generic definition of a financial institution. Instead, it has provided a list of entities that are stated to be financial institutions. A 'financial institution' is stated to be any of the following: *[FRS 102 Appendix I]*

(a) a bank which is:

  (i) a firm with a Part 4A permission (as defined in section 55A of the Financial Services and Markets Act 2000 or the equivalent provisions of any successor legislation) which includes accepting deposits and:

    (a) which is a credit institution; or

    (b) whose Part 4A permission includes a requirement that it complies with the rules in the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment Firms relating to banks, but which is not a building society, a friendly society or a credit union;

  (ii) an EEA bank which is a full credit institution;

(b) a building society which is defined in section 119(1) of the Building Societies Act 1986 as a building society incorporated (or deemed to be incorporated) under that act;

(c) a credit union, being a body corporate registered under the Co-operative and Community Benefit Societies Act 2014 as a credit union in accordance with the Credit Unions Act 1979, which is an authorised person;

(d) custodian bank or broker-dealer;

(e) an entity that undertakes the business of effecting or carrying out insurance contracts, including general and life assurance entities;

(f) an incorporated friendly society incorporated under the Friendly Societies Act 1992 or a registered friendly society registered under section 7(1)(a) of the Friendly Societies Act 1974 or any enactment which it replaced, including any registered branches;

(g) an investment trust, Irish Investment Company, venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC);

(h) any other entity whose principal activity is similar to those listed above but is not specifically included in the list above.

A parent entity whose sole activity is to hold investments in other group entities is not a financial institution.

The final category ((h) above) has been amended since the 2015 version of the standard, following a number of queries about how the definition of a financial institution was applied in practice and perceived anomalies within the definition. The principle has therefore been amended to remove references to 'generate wealth' and 'manage risk'. It is believed that these changes will both reduce the number of entities meeting the definition of a financial institution and will reduce interpretational difficulties with regard to implementing the concept. *[FRS 102.BC.B34D.4-5]*. It has additionally removed references to retirement benefit plans, as they are not deemed to be similar to the other institutions in the list and also to stockbrokers, as they are considered to be generally dissimilar from other entities as they do not hold financial instruments on behalf of others. *[FRS 102.BC.B34D.6-7]*

The difficulties in applying the previous definition to group treasury companies are acknowledged and it is believed that some of the issues have been alleviated by the change in definition. Nonetheless, it highlights that an assessment of whether such an entity is a financial institution will depend on individual facts and circumstances. Whether a group entity is similar to the other entities listed in the definition of a financial institution will require judgement. *[FRS 102.BC.B34D.8]*.

Identifying a group entity as a financial institution impacts both the disclosures that need to be given in the individual financial statements of that entity (prepared in accordance with FRS 102) and, where the financial instruments of the financial institution are material to the group, in the consolidated financial statements including the entity (where prepared in accordance with FRS 102) (see 2.5.1 above). If the risks arising from financial instruments are particularly significant to a business, additional disclosure may be required to enable users to evaluate the significance of those instruments, regardless of whether the entity meets the definition of a financial institution. If a group entity ceases to meet the definition of a financial institution, the disclosures relating to both the individual financial statements and the consolidated financial statements will no longer be required. *[FRS 102.BC.B34D.9]*.

2.5.2 Public benefit entities

Paragraphs in FRS 102 that are prefixed by PBE are specific to public benefit entities (see definition in the Glossary to FRS 102, and discussed further in Chapter 31 at 6).

These paragraphs must not be applied directly, or by analogy, to entities that are not public benefit entities (other than, where specifically directed, entities within a public benefit entity group, i.e. a public benefit entity parent and all its wholly-owned subsidiaries). *[FRS 102.1.2, FRS 102 Appendix I]*.

Section 34 addresses incoming resources from non-exchange transactions, public benefit entity combinations, and public benefit entity concessionary loans. These parts of Section 34 include paragraphs prefixed by PBE and, therefore, apply only to public benefit entities. Other sections of FRS 102 also contain paragraphs prefixed by PBE. Section 34 also addresses other accounting topics such as heritage assets and funding commitments, which may be of particular relevance to some public benefit entities, but (as the paragraphs are not prefixed by PBE) apply to all entities. See Chapter 31 at 6 and Chapter 19 at 3.9.

Many public benefit entities may also be subject to the requirements of a SORP (see 1.3.4 and 2.3 above).

3 REDUCED DISCLOSURE FRAMEWORK

FRS 102 provides for a reduced disclosure framework available only in the individual financial statements of a 'qualifying entity' (see 3.1 below). *[FRS 102.1.8-13]*. A qualifying entity which is required to prepare consolidated financial statements (for example, it is a parent company required by section 399 of the CA 2006 to prepare group accounts and is not entitled to any of the exemptions in sections 400 to 402 of the CA 2006 or chooses not to take advantage of these exemptions) may not take advantage of the disclosure exemptions in its consolidated financial statements. *[FRS 102.1.10]*. This does not preclude the reduced disclosure framework being applied in the individual financial statements of a parent preparing consolidated financial statements.

Individual financial statements to which FRS 102 applies are the accounts that are required to be prepared by an entity in accordance with the CA 2006 or relevant legislation, for example: 'individual accounts' as set out in section 394 of the CA 2006, a 'statement of accounts' as set out in section 132 of the Charities Act 2011, or 'individual accounts' as set out in section 72A of the Building Societies Act 1986. Separate financial statements are included in the meaning of the term 'individual financial statements'. *[FRS 102 Appendix I]*.

It is worth noting that FRS 102 uses the term 'separate financial statements' to mean those presented by a parent in which the investments in subsidiaries, jointly controlled entities or associates are accounted for either at cost or fair value rather than on the basis of the reported results and net assets of the investees. *[FRS 102 Appendix I]*. This differs to the definition of 'separate financial statements' in IFRSs. *[IAS 27.4]*.

This means that FRS 102's reduced disclosure framework can be used in:

- individual financial statements of subsidiary undertakings;
- separate financial statements of an intermediate parent undertaking which does not prepare consolidated financial statements; and
- separate financial statements of a parent undertaking which does prepare consolidated financial statements.

However, the entity applying FRS 102's reduced disclosure framework must be included in a set of publicly available consolidated financial statements intended to give a true and fair view (see 3.1.6 below).

A parent company that prepares consolidated financial statements but applies FRS 102 in its individual financial statements can also use the exemption in section 408 of the CA 2006 from presenting a profit and loss account and related notes in the individual financial statements. This is the case whether or not it applies FRS 102's reduced disclosure framework.

3.1 Definition of a qualifying entity

FRS 102 defines a qualifying entity as 'a member of a group where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation'. *[FRS 102 Appendix I]*. A charity can be a qualifying entity under FRS 102 (unlike under FRS 101).

There is no requirement that a qualifying entity is a member of the group in which it is consolidated for its entire reporting period. There is also no requirement that the financial statements of the qualifying entity and the consolidated financial statements of the parent of that group (which may be the reporting entity itself) must be coterminous or have reporting dates within a particular timeframe. The use of the present tense implies that the intention is only that the qualifying entity (where it does not prepare its own consolidated financial statements) is a subsidiary of the parent at its reporting date. This is consistent with UK company law which requires that an entity which is a parent at the end of the financial year must prepare group accounts unless it is exempted from the requirement. *[s399(2), s399(2) (LLP)]*.

The phrase 'included in the consolidation' is referenced to section 474(1) of the CA 2006 which states that this means that 'the undertaking is included in the accounts by the method of full (and not proportional) consolidation and references to an undertaking excluded from consolidation shall be construed accordingly'. Therefore, entities that are not fully consolidated in the consolidated financial statements, such as subsidiaries excluded from consolidation under FRS 102 *[FRS 102.9.9-9B]* or subsidiaries of investment entities that are accounted for at fair value through profit or loss under IFRS 10 – *Consolidated Financial Statements*, cannot use FRS 102's reduced disclosure framework. Associates and jointly controlled entities are not qualifying entities since they are not members of a group (see 3.1.2 below).

There is no requirement for the consolidated financial statements in which the qualifying entity is included to be prepared under FRS 102 nor that the parent that prepares the consolidated financial statements is a UK entity. However, the consolidated financial statements must be intended to give a true and fair view (see 3.1.6 below).

3.1.1 Reporting date of the consolidated financial statements of the parent

The requirement for the qualifying entity to be included in the consolidation implies that the consolidated financial statements of the parent should be approved before, or at the same time as, the FRS 102 individual financial statements of the qualifying entity are approved, where FRS 102's reduced disclosure framework is used in the individual financial statements of the qualifying entity. FRS 102 is silent on whether the reporting date and period of those consolidated financial statements has to be identical to that of the qualifying entity. In contrast, both sections 400 and 401 of the CA 2006 require that the exemption from preparing group accounts for a parent company that is a subsidiary undertaking is conditional on the inclusion of the company in consolidated financial statements of a parent undertaking drawn up to the same date or to an earlier date in the same financial year. It would seem logical that the reporting date criteria in sections 400 and 401 should also be used for FRS 102's reduced disclosure framework.

However, when the consolidated financial statements are prepared as at an earlier date than the date of the qualifying entity's financial statements, some of the disclosure exemptions may not be available to the qualifying entity because the consolidated financial statements may not contain the 'equivalent' disclosures (see 3.6 below).

3.1.2 Definition of 'group' and 'subsidiary'

The definition of a qualifying entity contains a footnote that refers to section 474(1) of the CA 2006 which defines a 'group' as a 'parent undertaking and its subsidiary undertakings'. *[s474(1)]*.

The CA 2006 states that an undertaking is a parent undertaking in relation to another undertaking, a subsidiary undertaking, if:

(a) it holds a majority of the voting rights in the undertaking;

(b) it is a member of the undertaking and has the right to appoint or remove a majority of its board of directors;

(c) it has the right to exercise a dominant influence over the undertaking by virtue of provisions contained in the undertaking's articles or by virtue of a control contract; or

(d) it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.

An undertaking should be treated as a member for the purposes above if any of its subsidiary undertakings is a member of that undertaking or if any shares in that other undertaking are held by a person acting on behalf of the undertaking or any of its subsidiary undertakings.

An undertaking is also a parent undertaking in relation to another (subsidiary) undertaking if it has the power to exercise, or actually exercises, dominant influence or control over it, or it and the subsidiary undertaking are managed on a unified basis.

A parent undertaking should be treated as the parent undertaking of undertakings in relation to which any of its subsidiary undertakings are, or are to be treated as, parent undertakings, and references to its subsidiary undertakings should be construed accordingly. *[s1162(1)-(5)]*. Schedule 7 to the CA 2006 provides interpretation and references to 'shares' in section 1162 and in Schedule 7 are to 'allotted shares'. *[s1162(6)-(7)]*.

FRS 102 defines a subsidiary as an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. FRS 102 goes on to explain in what circumstances control exists or can exist. *[FRS 102.9.4-6A]*. These circumstances are similar but not identical to those included in the definition of a subsidiary undertaking under section 1162.

Although there are slight differences in wording emphasis between the definition of a subsidiary undertaking in section 1162 and the requirements of Section 9 – *Consolidated and Separate Financial Statements*, we would expect to see few conflicts arising in practice between Section 9 and the CA 2006 (see Chapter 8 at 3.2). The key issue for the application of FRS 102's reduced disclosure framework is whether the subsidiary is included in the consolidation of the parent's consolidated financial statements. A company that meets the definition of a subsidiary undertaking under the CA 2006 but is not included in the consolidation of the consolidated financial statements of its parent cannot apply FRS 102's reduced disclosure framework.

3.1.3 Publicly available consolidated financial statements

By 'publicly available', we believe that FRS 102 requires that the consolidated financial statements can be accessed by the public as the use of FRS 102's reduced disclosure framework is conditional on a disclosure by the qualifying entity indicating from where those consolidated financial statements can be obtained (see 3.2 below). This does not mandate that the consolidated financial statements must be filed with a regulator. Therefore, for example, UK consolidated financial statements that have not been filed with the Registrar of Companies, at the date that the subsidiary's financial statements prepared in accordance with FRS 102 are approved, must be publicly available via some other medium.

3.1.4 Non-UK qualifying entities

There is no requirement that a qualifying entity is a UK entity. Non-UK entities can apply FRS 102's reduced disclosure framework in their individual or separate financial statements subject to meeting the criteria for its use, and provided FRS 102 is allowed for use in their own jurisdiction.

3.1.5 Non-controlling interests

There is no ownership threshold for a subsidiary to apply FRS 102's reduced disclosure framework. Therefore, a qualifying entity can apply the reduced disclosure framework even if its parent holds less than a majority of the voting rights, provided that the parent has control via other means (see Chapter 8 at 3.2).

3.1.6 Intended to give a true and fair view

In the definition of a qualifying entity (see 3.1 above), the consolidated financial statements in which the qualifying entity is included are not required to give an explicit true and fair view of the assets, liabilities, financial position and profit or loss. Rather, they are '*intended* to give a true and fair view' [emphasis added]. This means that the consolidated financial statements in which the qualifying entity is consolidated need not contain an explicit opinion that they give a 'true and fair view' but, in substance, they should be intended to give such a view. The FRC guidance – *True and Fair* – issued in June 2014 states that 'Fair presentation under IFRS is equivalent to a true and fair view'.

3.1.7 Equivalence

A UK parent company that wishes to claim an exemption from preparing group accounts under either section 400 or section 401 of the CA 2006 must be a subsidiary included in the consolidated accounts for a larger group. Those consolidated accounts (and where appropriate, the group's annual report) must be drawn up: *[s400(2)(b), s401(2)(b)]*

- in accordance with the provisions of Directive 2013/34/EU ('the Accounting Directive') (for sections 400 and 401);
- in a manner equivalent to consolidated accounts and consolidated reports so drawn up (for section 401);
- in accordance with international accounting standards adopted pursuant to the IAS Regulation, i.e. EU-adopted IFRS (for sections 400 and 401); or
- in accordance with accounting standards which are equivalent to international accounting standards, as determined pursuant to Commission Regulation (EC) No. 1569/2007 (for section 401).

There are similar requirements for a parent LLP but for section 401, there is no reference to the basis on which the consolidated reports are drawn up. *[s400(2)(b) (LLP), s401(2)(b) (LLP)]*.

We believe that references to 'in accordance with the Accounting Directive' in relation to a banking or insurance group in section 400 or section 401, mean as modified by the provisions of the Bank Accounts Directive or the Insurance Accounts Directive respectively. *[s400(2)(b), s401(2)(b), s400(2)(b) (LLP), s401(2)(b) (LLP)]*.

In our view, a set of consolidated financial statements that would meet the above criteria (i.e. the consolidated financial statements are drawn up in accordance with or in a manner equivalent to the Accounting Directive, or in accordance with EU-adopted IFRS or accounting standards which are equivalent to EU-adopted IFRS as determined by the mechanism established by the EU Commission) is intended to give a true and fair view.

The Application Guidance to FRS 100 states that consolidated financial statements of the higher parent will meet the exemption or the test of equivalence in the Accounting Directive if they are intended to give a true and fair view and:

- are prepared in accordance with FRS 102;
- are prepared in accordance with EU-adopted IFRS;
- are prepared in accordance with IFRS, subject to the consideration of the reason for any failure by the European Commission to adopt a standard or interpretation; or
- are prepared using other GAAPs which are closely related to IFRS, subject to consideration of the effect of any differences from EU-adopted IFRS.

Consolidated financial statements of the higher parent prepared using other GAAPs or the IFRS for SMEs should be assessed for equivalence with the Accounting Directive based on the particular facts, including the similarities to and differences from the Accounting Directive. *[FRS 100.AG6]*.

In accordance with Commission Regulation (EC) No. 1569/2007(a) of 21 December 2007 (see above), the EU Commission has identified the following GAAPs as equivalent to international accounting standards. This means that these GAAPs are equivalent to international accounting standards as a matter of UK law: *[FRS 100.AG7]*

Equivalent GAAP	*Applicable From*
GAAP of Japan	1 January 2009
GAAP of the United States of America	I January 2009
GAAP of the People's Republic of China	1 January 2012
GAAP of Canada	1 January 2012
GAAP of the Republic of Korea	1 January 2012

In addition, third country issuers were permitted to prepare their annual consolidated financial statements and half-yearly consolidated financial statements in accordance with the GAAP of the Republic of India for financial years starting before 1 April 2016. For reporting periods beginning on or after 1 April 2016, in relation to GAAP of the Republic of India, equivalence should be assessed on the basis of the particular facts. *[FRS 100.AG7]*.

The concept of equivalence for the purposes of section 401 is discussed further in Chapter 8 at 3.1.1.C.

In theory, there is no reason why consolidated financial statements of a parent prepared under a GAAP that is not 'equivalent' to the Accounting Directive cannot be used provided those consolidated financial statements in which the entity is included are publicly available and are intended to give a true and fair view.

In addition, a number of the disclosure exemptions under FRS 102's reduced disclosure framework are conditional on 'equivalent' disclosures being made in those publicly available consolidated financial statements in which the qualifying entity is included. *[FRS 102.1.13]*. Where the equivalent disclosure is not made, the relevant disclosure exemptions cannot be applied in the qualifying entity's individual financial statements prepared under FRS 102 (see 3.6 below). A GAAP that is not 'equivalent' to the Accounting Directive is less likely to have those 'equivalent' disclosures.

One issue not addressed by FRS 102 is the impact of a qualified audit opinion on the parent's consolidated financial statements. A Queen's Counsel's opinion, obtained by the FRC in 2008, stated that 'the scope for arguing that financial statements which do not comply with relevant accounting standards nevertheless give a true and fair view, or a fair presentation, is very limited'.[1]

3.2 Use of the disclosure exemptions

The use of the disclosure exemptions in FRS 102's reduced disclosure framework (see 3.3 to 3.5 below) is conditional on all of the following criteria being met:

- the reporting entity applies the recognition, measurement and disclosure requirements of FRS 102;
- the reporting entity discloses in the notes to its financial statements:
  - a brief narrative summary of the disclosure exemptions adopted; and
  - the name of the parent of the group in whose consolidated financial statements its financial statements are consolidated (i.e. the parent identified in the definition of 'qualifying entity') and from where those financial statements may be obtained. *[FRS 102.1.11]*.

There is no requirement to list all of the disclosure exemptions in detail. Reporting entities can also choose to apply the disclosure exemptions on a selective basis. This may be necessary, for example, where not all of the relevant 'equivalent disclosures' are made in the consolidated financial statements of the parent on the grounds of materiality (see 3.6 below).

3.3 Disclosure exemptions for qualifying entities

A qualifying entity may take advantage of the following disclosure exemptions in its individual financial statements: *[FRS 102.1.8, 1.9, 1.12]*

- the requirements of Section 7 – *Statement of Cash Flows* – and Section 3 – *Financial Statement Presentation*, paragraph 3.17(d) (see 3.3.1 below);
- the requirements of:
  - Section 11, paragraphs 11.42, 11.44, 11.45, 11.47, 11.48(a)(iii), 11.48(a)(iv), 11.48(b) and 11.48(c); and
  - Section 12, paragraphs 12.26 (in relation to those cross-referenced paragraphs from which a disclosure exemption is available), 12.27, 12.29(a), 12.29(b) and 12.29A.

  These disclosure exemptions are subject to certain conditions and exceptions. See 3.3.2 and 3.4 below;
- the requirements of Section 26 – *Share-based Payment,* paragraphs 26.18(b), 26.19 to 26.21 and 26.23, provided that for a qualifying entity that is:
  - a subsidiary, the share-based payment arrangement concerns equity instruments of another group entity;
  - an ultimate parent, the share-based payment arrangement concerns its own equity instruments and its separate financial statements are presented alongside the consolidated financial statements of the group;

  and, in both cases, provided that the equivalent disclosures required by FRS 102 are included in the consolidated financial statements of the group in which the entity is consolidated (see 3.3.3 below);
- the requirement of Section 33 – *Related Party Disclosures*, paragraph 33.7 (see 3.3.4 below).

Qualifying entities must still ensure that they comply with any relevant legal requirements. FRS 102 does not necessarily contain all legal disclosure requirements. *[FRS 102.1.2A]*.

3.3.1 Statement of cash flows

The exemption removes the requirement for a cash flow statement for any qualifying entity in its individual financial statements.

3.3.2 Financial instruments

The exemption removes certain of the disclosure requirements of Sections 11 and 12 (see 3.3 above). *[FRS 102.1.12(c)]*.

Financial institutions are not permitted to use this exemption (see 3.5 below).

The exemption depends on there being equivalent disclosures in the publicly available consolidated financial statements in which the qualifying entity is included. The guidance on 'equivalence' included in FRS 100 (see 3.6 below) is clear that the exemption can be taken in relation to intra-group balances that are eliminated on consolidation in these consolidated financial statements.

Notwithstanding this exemption, where a qualifying entity that is not a financial institution has financial instruments held at fair value subject to the requirements of paragraph 36(4) of Schedule 1 to the Regulations (or its equivalents in the Small Companies Regulations, LLP Regulations or Small LLP Regulations), it must give the disclosures required by 'international accounting standards' (see 3.4 below). *[1 Sch 36(4), 1 Sch 36(4) (LLP)]*.

The reduction in disclosure exemptions in relation to Sections 11 and 12 applies even if the qualifying entity is *not* subject to UK company and LLP law. See Chapter 10 at 11.2.1.

3.3.2.A Other disclosures required by the Regulations for financial instruments

Qualifying entities must also ensure that they comply with any relevant legal requirements. The standard does not necessarily contain all legal disclosure requirements. *[FRS 102.1.2A]*.

FRS 102 financial statements prepared in accordance with Part 15 of the CA 2006 are Companies Act accounts. A UK company's statutory accounts prepared in accordance with FRS 102 should give the disclosures in respect of financial instruments required by the Regulations (or by the Small Companies Regulations) even if the company is a qualifying entity using the reduced disclosure framework. Similarly, a UK LLP should comply with the disclosure requirements of the LLP Regulations (or the Small LLP Regulations).

In particular, qualifying entities that are preparing Companies Act accounts must provide the disclosures required by paragraph 55 of Schedule 1 to the Regulations (and its equivalents in the Small Companies Regulations, LLP Regulations and Small LLP Regulations) which set out requirements relating to financial instruments at fair value. These disclosures relate to financial instruments held at fair value generally and not just to those financial instruments measured at fair value in accordance with paragraph 36(4) as discussed at 3.4 below. FRS 102 reporters applying IFRS 9 or IAS 39 to the recognition and measurement of financial instruments may have financial instruments measured at fair value, but with fair value changes outside profit and loss. Appendix III to FRS 102 states that most of these disclosures will be satisfied by equivalent requirements of FRS 102 but cautions that entities will need to take care to ensure appropriate disclosure of derivatives is provided. *[FRS 102 Appendix III.12D]*.

Disclosures are required of: *[1 Sch 55, 1 Sch 53 (LLP)]*

- the significant assumptions underlying the valuation models and techniques used when determining the fair value of the instruments;
- for each category of financial instrument, the fair value of the [instruments] in that category and the changes in value:
  - included directly in the profit and loss account; or
  - credited to or (as the case may be) debited from the fair value reserve;
- for each class of derivatives, the extent and nature of the instruments, including significant terms and conditions that may affect the timing and certainty of future cash flows; and
- a tabular disclosure of amounts transferred to or from the fair value reserve reconciling the opening and closing balance of the reserve, showing the amount transferred to or from the reserve during the year and the source and application of the amounts so transferred.

While the Regulations refer to 'assets' rather than 'instruments' in the second bullet above, this appears to be a typographical error.

There are, however, other differences in the disclosures between FRS 102 and the Regulations. For example, the Regulations contain disclosures concerning investments and loans that have not been included in FRS 102. *[1 Sch 50, 1 Sch 54, 1 Sch 61, 1 Sch 48 (LLP), 1 Sch 52 (LLP), 1 Sch 59 (LLP)]*. Care is needed to ensure compliance with the statutory requirements in addition to the disclosures listed in the standard. See Chapter 10 at 11.2.5 for further statutory disclosures for financial instruments required in the accounts of a UK company.

In addition, the Regulations require that the directors' report of a UK company should contain, in relation to the use of financial instruments, an indication of the financial risk management objectives, policies (including the policy for hedging each major type of forecasted transaction for which hedge accounting is used) and the exposure of the company to price risk, credit risk, liquidity risk and cash flow risk, unless not material. In respect of a group directors' report, this information is required for the company and its consolidated subsidiary undertakings. *[7 Sch 6]*. These requirements do not apply to LLPs.

3.3.3 Share-based payment

This exemption removes all the disclosure requirements of Section 26 except for the following:

- a description of each type of share-based payment arrangements that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (e.g. whether in cash or equity). An entity with substantially similar types of share-based payment arrangement may aggregate this information; *[FRS 102.26.18(a)]* and
- if the entity is part of a group share-based payment plan, and it recognises and measures its share-based payment expense on the basis of a reasonable allocation of the expense recognised for the group, it shall disclose that fact and the basis for the allocation (addressed further in paragraph 26.16). *[FRS 102.26.22]*.

3.3.4 Related party transactions

This exemption removes the requirement to disclose key management personnel compensation in total. *[FRS 102.1.12(e)]*.

3.4 Disclosures required by the Regulations in the financial statements for certain financial instruments held at fair value

As set out in 3.3 above, a qualifying entity may take advantage of the following disclosure exemptions for financial instruments in its individual financial statements, the requirements of: *[FRS 102.1.8, 1.9, 1.12]*

- Section 11, paragraphs 11.42, 11.44, 11.45, 11.47, 11.48(a)(iii), 11.48(a)(iv), 11.48(b) and 11.48(c); and
- Section 12, paragraphs 12.26 (in relation to those cross-referenced paragraphs from which a disclosure exemption is available), 12.27, 12.29(a), 12.29(b) and 12.29A.

Financial institutions are in any event required to give the disclosures required by Section 11 and Section 12, although care may be required in order to comply with the statutory requirements (see 3.5 below for further discussion). All qualifying entities must now make the disclosures required by paragraph 41 of Section 11 (as amended by the Triennial review 2017), requiring an entity to show separately the carrying amounts at the reporting date of financial assets and liabilities measured at fair value through profit or loss.

The Triennial review 2017 has also removed a requirement for a qualifying entity that is not a financial institution to apply the disclosure requirements of Section 11 to those financial instruments held at fair value subject to the requirements of paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents). However, the disclosures required by paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents) will still need to be given.

See 3.4.1 below for a discussion of which financial instruments are held at fair value in accordance with paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents).

See 3.4.2 below for a discussion of the disclosure requirements where financial instruments are held at fair value in accordance with paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents).

3.4.1 Which financial instruments may be included at fair value in accordance with paragraph 36(4) of Schedule 1 to the Regulations?

Paragraph 36 of Schedule 1 to the Regulations (and its equivalents in Schedules 2 and 3 to the Regulations, the Small Companies Regulations, LLP Regulations and Small LLP Regulations) allow financial instruments to be included in the financial statements at fair value, where their fair value can be measured reliably, but paragraphs 36(2) and 36(3) exclude certain types of financial instruments, unless these are permitted to be held at fair value by paragraph 36(4). *[1 Sch 36, 2 Sch 44, 3 Sch 30, 1 Sch 36 (SC), 1 Sch 36 (LLP), 1 Sch 36 (LLP SC)]*.

Paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents) state that 'financial instruments which under international accounting standards may be included in accounts at fair value, may be so included, provided that the disclosures required by such accounting standards are made.' *[1 Sch 36(4), 1 Sch 36(4) (LLP)]*.

The reference to 'international accounting standards' in this context would mean EU-adopted IFRS. *[s474, s 474(LLP)]*. Accordingly, reference is made to extant EU-adopted IFRS in determining whether certain financial instruments may be held at fair value and the required disclosures.

Financial instruments listed in paragraphs 36(2)(c) and 36(3) of Schedule 1 to the Regulations (and its equivalents) are as follows:

- financial liabilities, unless they are held as part of a trading portfolio or are derivatives;
- financial instruments (other than derivatives) held to maturity;
- loans and receivables originated by the company (or the LLP) and not held for trading purposes;
- interests in subsidiary undertakings, associated undertakings and joint ventures;
- equity instruments issued by the company (or the LLP);
- contracts for contingent consideration in a business combination; or
- other financial instruments with such special characteristics that the instruments according to generally accepted accounting principles or practice, should be accounted for differently from other financial instruments. *[1 Sch 36(2)-36(3), 1 Sch 36(2) (LLP)-36(3) (LLP)]*.

FRS 102 allows a choice of applying either IAS 39, IFRS 9, or Sections 11 and 12 in the recognition and measurement of financial instruments. The situations in which financial instruments are carried at fair value under FRS 102 will differ depending on the choice taken. Following the adoption by the EU of IFRS 9, this standard is now the principal point of reference for which financial instruments may be included in the accounts at fair value when referring to paragraph 36(4) of Schedule I to the Regulations.

Furthermore, the Regulations (and its equivalents) were written with the application of the previously extant IAS 39 in mind. Terms such as 'loans and receivables', 'held to maturity' and 'held for trading' are not defined in FRS 102. The Regulations indicate that these terms are defined in the Accounting Directive (Directive 2013/34/EU) and Directive 91/674/EEC (for insurance undertakings) and in paragraph 96 of Schedule 2 to the Regulations (for banking companies). *[10 Sch 3(1), 4 Sch 2(1) (LLP)]*. Some of these terms are no longer used in IFRS 9 and therefore it would be necessary to refer back to definitions under the version of IAS 39 extant immediately before the introduction of IFRS 9.

Sections 11 and 12, where applied to the recognition and measurement of financial instruments, distinguish between basic and other financial instruments. These requirements differ significantly to those of IAS 39 and IFRS 9. Most basic financial instruments (with certain exceptions) are carried at cost or amortised cost, whereas other financial instruments are carried at fair value through profit or loss. For other financial instruments, Section 12 does not permit measurement at fair value through profit or loss where this is not permitted by the Regulations (and its equivalents). *[FRS 102.12.8(c)]*. Hence the potential for conflict between Sections 11 and 12 and the Regulations (and its equivalents) over financial instruments permitted to be carried at fair value should be limited. See Chapter 10 at 6 for a discussion of the classification and measurement of financial instruments and which financial instruments may be held at fair value under Sections 11 and 12.

Financial instruments that are held at fair value subject to paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents) in FRS 102 financial statements (under any of the accounting choices) therefore include:

(a) financial liabilities (which are not held as part of a trading portfolio nor derivatives) that are designated at fair value through profit or loss – because this eliminates or significantly reduces an 'accounting mismatch' or a group of financial assets and/or financial liabilities is managed and its performance evaluated on a fair value basis (IAS 39, IFRS 9 and Section 11 have similar but not identically worded provisions); *[IAS 39.9, IFRS 9.4.2.2, FRS 102.11.14(b)]*

(b) where Section 11 is applied, financial liabilities (which are not held as part of a trading portfolio nor derivatives) that do not qualify as basic financial instruments, but would meet the conditions to be measured or designated at fair value through profit or loss under EU-adopted IFRS (i.e. under paragraphs 4.3.5 and 4.3.6 of IFRS 9); *[IFRS 9.4.2.2, 4.3.5-6]*

(c) where IAS 39 or IFRS 9 are applied, financial liabilities (which are not held as part of a trading portfolio nor derivatives) that are not covered by (a), but are measured or designated at fair value through profit or loss; *[IAS 39.11A, 12, IFRS 9.4.3.5-6]*

(d) financial assets, which could have been designated as held to maturity (which are not derivatives) or loans and receivables originated by the reporting entity (and which are not held for trading purposes) that:

    (i) where IAS 39 is applied, are designated at either available-for-sale or are measured or designated at fair value through profit or loss (i.e. under paragraphs 9, 11A or 12 of IAS 39) – but would meet the conditions to be measured or designated at fair value under EU-adopted IFRS; *[IAS 39.9, 11A, 12, IFRS 9.4.1.2A, 4.1.4-5, IFRS 9.4.3.5-6]*

    (ii) where Section 11 is applied, are designated at fair value through profit or loss; *[FRS 102.11.14(b)]*

    (iii) where Section 11 is applied, do not qualify as basic financial instruments but would meet the conditions to be measured or designated at fair value through profit or loss under EU-adopted IFRS); *[FRS 102.11.14(b), 12.8(c), IFRS 9.4.1.4-5, IFRS 9.4.3.5-6]*

    (iv) are measured at fair value in accordance with IFRS 9 (which is extant EU-adopted IFRS); *[IFRS 9.4.1.2A, 4.1.4-5]* and

(e) investments in subsidiaries, associated undertakings and joint ventures measured at fair value through profit or loss in consolidated or individual financial statements. *[FRS 102.9.9-9B, 9.26(c), 14.4(d), 14.4B, 15.9(d), 15.9B]*. See Chapter 8 at 3.4, 4.1 and 4.2, Chapter 12 at 3.3.1 and Chapter 13 at 3.6.2 and 3.6.3.

FRS 102 permits or requires investments in subsidiaries, associates and joint ventures to be measured at fair value in consolidated and/or individual financial statements in certain circumstances. However, where such investments are held at fair value through profit and loss, these fall within the scope of paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents). The interaction with company and LLP law is explained further in Chapter 6 at 10.3.1.C.

Contingent consideration arising in a business combination is not permitted to be held at fair value (whatever accounting policy choice is applied to the recognition and measurement of financial instruments). *[FRS 102.19.12-13, FRS 102.BC.A.28]*. Equity instruments are not held at fair value under Section 22 – *Liabilities and Equity*.

3.4.2 What disclosures are required by paragraph 36(4) to Schedule 1 to the Regulations?

Appendix III to FRS 102 comments that an entity applying FRS 102 and holding financial instruments measured at fair value may be required to provide the disclosures required by paragraph 36(4) of Schedule 1 to the Regulations. *[FRS 102 Appendix III.13]*.

As noted at 3.4.1 above, the disclosures required by paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents) are those in extant EU-adopted IFRS, as confirmed by Appendix II – *Note on legal requirements* – to FRS 101 which addresses the same paragraph. *[FRS 101 Appendix II.7]*. The most logical interpretation of this is that an entity should make all material disclosures required by IFRS 7 – *Financial Instruments: Disclosures* – and IFRS 13 – *Fair Value Measurement* – in respect of such financial instruments.

However, Appendix III to FRS 102 states that the disclosures required by paragraph 36(4) of Schedule 1 to the Regulations have been incorporated into Section 11. Some of the disclosure requirements of Section 11 apply to all financial instruments measured at fair value, whilst others (such as paragraph 11.48A) apply only to certain financial instruments (this does not include financial instruments held as part of a trading portfolio nor derivatives). The disclosure requirements of paragraph 11.48A will predominantly apply to certain financial liabilities, however, there may be instances where paragraph 36(3) of Schedule 1 to the Regulations requires that the disclosures must also be provided in relation to financial assets, e.g. investments in subsidiaries, associates or jointly controlled entities measured at fair value through profit or loss. *[FRS 102 Appendix III.13, FRS 102.9.27B]*.

While the guidance in Appendix III above (and the amendments made to the disclosures covered by the reduced disclosure framework), implies that FRS 102 reporters complying with the disclosures included in Sections 11 and 12 will meet the disclosure requirements of paragraph 36(4) of Schedule 1 to the Regulations (and its equivalents), we consider that care needs to be taken with both the scope of the disclosures and which disclosures are required. In any event, FRS 102 reminds entities that they must ensure that they comply with any relevant legal requirements applicable to them and that the standard does not necessarily contain all legal disclosure requirements. *[FRS 102.1.2A]*.

The disclosure requirements of Sections 11 and 12 apply to financial instruments within the scope of whichever accounting standard is applied for the recognition and measurement of financial instruments. *[FRS 102.11.1, 11.7, 12.1, 12.3, 12.26]*.

Paragraph 11.48A, which is excluded from the disclosure exemptions in the reduced disclosure framework, has a more restricted scope. It states that: 'An entity, *including an entity that is not a company*, shall provide the following disclosures only for financial instruments measured at *fair value through profit or loss in accordance with paragraph 36(4) of Schedule 1 to the Regulations*. This does not include financial liabilities held as part of a trading portfolio nor derivatives.' [emphasis added]. *[FRS 102.11.48A]*.

However, the reference to an 'entity, including an entity that is not a company' implies that the disclosures in paragraph 11.48A should be given by entities that are not subject to the statutory requirements in paragraph 36(4) of Schedule 1 to the Regulations (or its equivalents) if they hold financial instruments that would fall within that paragraph as if the entity had been a UK company.

FRS 102 also requires a parent adopting a policy of accounting for its investments in subsidiaries, associates or jointly controlled entities at fair value through profit or loss in its separate financial statements to comply with the requirements of paragraph 36(4) of Schedule 1 to the Regulations by applying the disclosure requirements of Section 11 to those investments. *[FRS 102.9.27B]*. This means that all applicable disclosures in Section 11 must be given in respect of those investments. In our view, the same requirement would also apply where investments in subsidiaries, associates or jointly controlled entities are held at fair value through profit or loss in the consolidated financial statements or in the individual financial statements of an investor or venturer (that is not a parent).

Care should also be taken where IAS 39 or IFRS 9 is applied to the recognition and measurement of financial instruments, as financial instruments held at fair value (but not through profit or loss) may in principle be held at fair value subject to paragraph 36(4) of Schedule 1 to the Regulations (or its equivalents). Examples might include an available-for-sale financial asset or debt instrument at fair value through other comprehensive income that falls within the financial instruments listed in paragraph 36(3). Section 11 and Section 12's disclosure requirements for financial instruments at fair value, including paragraph 11.48A, are generally framed in respect of financial instruments at fair value through profit or loss (and therefore may not capture all financial instruments for which disclosures are required – see Chapter 10 at 11.2).

3.5 Entities that are financial institutions

A qualifying entity that is a financial institution (see 2.5.1.A above) may take advantage in its individual financial statements of the disclosure exemptions set out in 3.3 above, except for the disclosure exemptions from Sections 11 and 12. *[FRS 102.1.9]*.

Where an entity has financial instruments held at fair value subject to the requirements of paragraph 36(4) of Schedule 1 to the Regulations (or its equivalents), it is required to give the disclosures required by extant IFRSs adopted by the EU. The FRC has identified these disclosures as being the disclosure requirements of Section 11. Since financial institutions do not benefit from disclosure exemptions in respect of Section 11, under the reduced disclosure framework, this implies that financial institutions will already be giving the required disclosures in respect of financial instruments. However, in our view, care needs to be taken with both the scope of the disclosures and which disclosures are required. This is particularly relevant where investments in subsidiaries, associates and joint ventures are measured at fair value through profit or loss or where IFRS 9 or IAS 39 is applied to the recognition and measurement of financial instruments. See 3.4 above.

An entity that is a financial institution must also give the disclosures set out in Section 34 for financial institutions (see 2.5.1 above).

Qualifying entities must also ensure that they comply with any relevant legal requirements. FRS 102 does not necessarily contain all legal disclosure requirements. *[FRS 102.1.2A]*.

Therefore, an entity subject to these statutory requirements must also give the disclosures required by the CA 2006 and the Regulations (or the Small Companies Regulations, LLP Regulations or Small LLP Regulations). See 3.3.2.A above.

3.6 Equivalent disclosures

The disclosure exemptions in respect of financial instruments and share-based payments set out in paragraphs 1.12(c) and (d) respectively of FRS 102 are dependent on the provision of 'equivalent' disclosures in the publicly available consolidated financial statements of the parent in which the qualifying entity is included.

FRS 102 refers to the Application Guidance in FRS 100 in deciding whether the consolidated financial statements of the group in which the reporting entity is included provides disclosures that are 'equivalent' to the requirements of FRS 102 from which relief is provided. *[FRS 102.1.13]*.

The Application Guidance in FRS 100 states that:

- it is necessary to consider whether the consolidated financial statements of the parent provide disclosures that meet the basic disclosure requirements of the relevant standard or interpretation without regarding strict conformity with each and every disclosure. This assessment should be based on the particular facts, including the similarities to and differences from the requirements of the relevant standard from which relief is provided. 'Equivalence' is intended to be aligned to that described in section 401 of the CA 2006 (see Chapter 8 at 3.1.1.C and 3.1.6 above); *[FRS 100.AG8-9]* and
- disclosure exemptions for subsidiaries are permitted where the relevant disclosure requirements are met in the consolidated financial statements, even where the disclosures are made in aggregate or in an abbreviated form, or in relation to intra-group balances, those intra-group balances have been eliminated on consolidation. If, however, no disclosure is made in the consolidated financial statements on the grounds of materiality, the relevant disclosures should be made at the subsidiary level if material in those financial statements. *[FRS 100.AG10]*.

This means that a qualifying entity must review the consolidated financial statements of its parent to ensure that 'equivalent' disclosures have been made for each of the above exemptions that it intends to use. Where a particular 'equivalent' disclosure has not been made (unless the disclosure relates to an intra-group balance eliminated on consolidation) then the qualifying subsidiary cannot use the exemption in respect of that disclosure.

4 CA 2006 REQUIREMENTS

The requirements of the CA 2006 (and certain other regulatory rules) governing preparation of financial statements by UK companies are addressed in Chapter 1 at 6. See also 2.1 above for the requirements for which entities can apply FRS 102.

Qualifying entities must also ensure that they comply with any relevant legal requirements. FRS 102 does not necessarily contain all legal disclosure requirements. *[FRS 102.1.2A]*.

Statutory accounts prepared by a UK company in accordance with FRS 102 are Companies Act individual or group accounts, and are therefore required to comply with the applicable provisions of Parts 15 and 16 of the CA 2006 and with the Regulations. *[FRS 102 Appendix III.7]*. These requirements include the rules on recognition and measurement, the Companies Act accounts formats and note disclosures (see Chapter 6). While Appendix III to FRS 102, when discussing legal requirements relevant to FRS 102 financial statements, generally refers to specific provisions of Schedule 1 to the Regulations, entities applying Schedules 2, 3 or 6 to the Regulations should read such references as referring to the equivalent paragraph in those schedules. *[FRS 102 Appendix III.3]*.

Similar provisions (to those for UK companies) also apply to LLPs in Schedule 1 to the LLP Regulations or Schedule 1 to the Small LLP Regulations.

Appendix III states that it does not list every legal requirement but instead focuses on those areas where greater judgement might be required in determining compliance with the law. *[FRS 102 Appendix III.11]*. It notes that the standard 'is not intended to be a one-stop-shop for all accounting and legal requirements, and although the FRC believes the FRS 102 is not inconsistent with company law, compliance with FRS 102 alone will often be insufficient to ensure compliance with all the disclosure requirements set out in the Act and the Regulations. As a result preparers will continue to be required to have regard to the requirements of company law in addition to accounting standards.' *[FRS 102 Appendix III.10]*.

4.1 Small and medium-sized entities

This section is relevant to small and medium-sized companies and LLPs that do not apply Section 1A of FRS 102. The requirements for entities applying Section 1A are covered in Chapter 5.

While this section refers to companies and LLPs, there are equivalent provisions for a qualifying partnership preparing the 'like accounts and reports', as if a UK company, in accordance with the *Partnerships (Accounts) Regulations 2008*. See Chapter 6 at 4.2.4.

4.1.1 Small companies regime, small LLPs regime and small companies exemption

A UK company subject to the small companies regime (or an LLP subject to the small LLPs regime) can apply the Small Companies Regulations (or the Small LLP Regulations) and is exempt from the requirement to prepare group accounts and from giving certain disclosures required in the notes to the financial statements by Part 15 of the CA 2006. LLPs subject to the small LLPs regime are exempt from the requirement to prepare group accounts.

A UK company that takes advantage of the small companies exemption is not required to prepare a strategic report, *[s414A]*, and is entitled to certain disclosure exemptions in the directors' report. *[s415A]*. LLPs are not required to prepare a directors' report or strategic report and there is, therefore, no equivalent of the small companies exemption for LLPs. Some LLPs choose to prepare a separate members' report but this is not a statutory requirement; while the LLP SORP includes certain disclosures (such as principal activities, a list of designated members etc.) that could be included in such a report, the disclosures may be presented anywhere in the annual report. *[LLP SORP.30-31]*.

A UK company subject to the small companies regime or taking advantage of the small companies exemption is entitled to certain filing exemptions. An LLP subject to the small LLPs regime is also entitled to filing exemptions. The criteria for use of the small companies regime, small LLPs regime and the small companies exemption (which has a wider scope than the small companies regime), together with the exemptions available, are discussed in Chapter 5 at 4 and 12.

FRS 102 (where Section 1A is not applied) requires use of the profit and loss account and balance sheet formats included in Part 1 'General Rules and Formats' of Schedule 1 (or where applicable, Schedule 2 or Schedule 3) to the Regulations or Part 1 'General Rules and Formats' of Schedule 1 to the LLP Regulations. As explained in Chapter 6 at 4, there is a choice of adapted formats or statutory formats where Schedule 1 to the Regulations or the LLP Regulations are applied. Unless Section 1A is applied, a small company or small LLP is not permitted to use the formats included in Part 1 'General Rules and Formats' of Schedule 1 to the Small Companies Regulations or Part 1 'General Rules and Formats' of Schedule 1 to the Small LLP Regulations.

However, our view is that companies and LLPs applying FRS 102 (but not Section 1A) are not prevented from taking advantage of other exemptions applicable to companies subject to the small companies regime or LLPs subject to the small LLPs regime. This is because regulation 3(3) of the Small Companies Regulations specifically states that 'Accounts are treated as having complied with any provision of Schedule 1 to these Regulations if they comply instead with the corresponding provision of Schedule 1 to *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008*.' Regulation 8(2) of the Small Companies Regulations makes a similar statement in respect of the group accounts formats included in Schedule 6 to the Small Companies Regulations and Schedule 6 to the Regulations. *[Regulations SC 3(3), 8(2)]*. For LLPs, the corresponding statements are made in paragraphs 3(1) and 6(1) of the Small LLP Regulations. *[LLP SC Regulations 3(1), 6(1)]*.

4.1.2 Medium-sized companies and LLPs

A medium-sized company (or LLP) may take advantage of certain disclosure exemptions for a financial year in which the company (or the LLP) qualifies as medium-sized and is not an excluded company (or LLP) (see Chapter 1 at 6.6). *[s465-s467, s465 (LLP)-s467 (LLP)]*. The exemptions for medium-sized companies impacting the strategic report (not to disclose non-financial KPIs) are not relevant for LLPs.

Companies (or LLPs) applying FRS 102 can make use of these exemptions to the extent they do not conflict with accounting standards, e.g. medium-sized companies would need to give related party disclosures in individual financial statements because this is required by FRS 102 notwithstanding the exemption in the Regulations. *[Regulations 4(2B), LLP Regulations 4(2B)]*.

References

1 *The Financial Reporting Council: The True and Fair Requirement Revisited* – Opinion by Martin Moore QC, May 2008, para. 4(F).

Chapter 4 Concepts and pervasive principles

Chapter 4 Concepts and pervasive principles

1 INTRODUCTION

Section 2 – *Concepts and Pervasive Principles* – sets out the objectives of the financial statements of entities within the scope of FRS 102 and the qualities that make those financial statements useful. It also sets out the concepts and basic principles underlying the financial statements of entities within the scope of FRS 102. *[FRS 102.2.1]*.

Section 2 is FRS 102's equivalent of the IFRS Conceptual Framework for Financial Reporting. An updated IFRS Conceptual Framework was published in March 2018, replacing the 2010 version, and has been in use by the International Accounting Standards Board (IASB) from that date, though preparers are not required to use the updated framework until January 2020. Section 2 is not a statement or framework as such but a list of concepts and pervasive principles that underlie the Standard. The concepts and pervasive principles are largely derived from the equivalent concepts and pervasive principles section in the IFRS for SMEs. However, there are some differences in wording.

Section 2 affects recognition and measurement only when FRS 102 or a Statement of Recommended Practice (SORP) does not specifically address the accounting for a transaction, other event or condition. In the absence of such guidance, management has to refer to the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles within Section 2 in using its judgment in developing and applying a relevant and reliable accounting policy for that transaction, other event or condition. *[FRS 102.10.4-5]*.

In recognition of this hierarchy of sources, it is reiterated that where there is an inconsistency between the concepts and principles in Section 2 and the specific requirements of another section of FRS 102, then the specific requirements of that other section take precedence. *[FRS 102.2.1A]*.

Section 2 introduces a number of definitions which are discussed separately below.

2 COMPARISON BETWEEN SECTION 2 AND IFRS

There are some differences between the concepts and pervasive principles of FRS 102 and the IFRS Conceptual Framework for Financial Reporting published in March 2018 (the IFRS Conceptual Framework). Furthermore, FRS 102 does not address all the concepts covered by the IFRS Conceptual Framework – for example the concepts of capital and capital maintenance. However, these differences and lacunae are unlikely to result in any recognition and measurement differences in practice since the definitions that actually affect amounts reported in the financial statements are virtually identical.

The main conceptual difference is that Section 2 does not identify any of its qualitative characteristics of information in financial statements as 'fundamental', 'enhancing' or otherwise assign priority. FRS 102 sets out ten qualitative characteristics, none of which are given precedence over the others. The IFRS Conceptual Framework identifies two fundamental qualitative characteristics, relevance, including materiality, and faithful representation as well as four enhancing qualitative characteristics, comparability, verifiability, timeliness and understandability.[1] Neither faithful representation, nor its related qualitative characteristic, verifiability, are qualitative characteristics of FRS 102. However, in terms of financial reporting, this difference of emphasis has little, if any, practical impact.

Section 2 defines stewardship as the 'accountability of management for the resources entrusted to it'. The 2010 version of the IFRS Conceptual Framework did not use the term 'stewardship' because of the difficulty in translating the concept. The term 'stewardship' has now been explicitly reintroduced into the IFRS Conceptual Framework, though a definition of the term is not provided. The framework instead contains a description of what stewardship encapsulates: 'Information about how efficiently and effectively the reporting entity's management has discharged its responsibilities to use the entity's economic resources...' The IFRS Conceptual Framework gives examples of management's responsibilities to use the entity's economic resources: protecting those resources from unfavourable effects of economic factors, such as price and technological changes and ensuring the entity complies with applicable laws, regulations and contractual provisions. Despite the longer exposition of the meaning of stewardship in the IFRS Conceptual framework, we do not believe that there is any conceptual difference between FRS 102 and the IFRS Conceptual Framework.[2]

3 THE CONCEPTS AND PERVASIVE PRINCIPLES OF SECTION 2

Section 2 explains the objective of financial statements, the qualitative characteristics of information in financial statements, the financial position of an entity, performance, and the recognition and measurement principles of assets, liabilities, income and expenses. Each of these is discussed below.

3.1 Objective of financial statements

There are two overriding objectives of financial statements:

- to provide information about the financial position, performance and cash flows of an entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs; and
- to show the results of the stewardship of management – the accountability of management for the resources entrusted to it. *[FRS 102.2.2-3]*.

These objectives are broader than the IFRS Conceptual Framework which limits users to potential investors, lenders and other creditors. In contrast, there is no limit put on the 'broad range of users' by Section 2.

The inclusion of stewardship as an objective of financial reporting in FRS 102 is consistent with past publications of the ASB (the predecessor body to the FRC). In June 2007, the ASB and others published a paper discussing the rationale for including stewardship, or directors' accountability to shareholders, as a separate objective of financial reporting.[3]

The inclusion of both of these objectives in FRS 102 is an attempt to reconcile two differing strands of thought regarding the purpose of financial statements; the view that financial statements are forward-looking, assisting a user in making economic decisions about future interactions with the entity and the view that financial statements are backward-looking, recording past performance, based on the effectiveness of management's stewardship of the economic resources entrusted to it.

3.2 Qualitative characteristics of information in financial statements

Section 2 identifies ten qualitative characteristics of information in financial statements. It does not describe any of these qualitative characteristics as 'fundamental', 'key' or otherwise assign priority. However, the language that describes the qualitative characteristics places emphasis on how those qualitative characteristics make financial statements relevant and reliable.

Going concern is not one of the qualitative characteristics identified by Section 2. The subject of going concern is addressed separately in Section 3 – *Financial Statement Presentation* (see Chapter 6 at 9.3).

Each of FRS 102's ten qualitative characteristics are discussed in sections 3.2.1 to 3.2.10 below.

3.2.1 Understandability

Understandability is described as the presentation of information in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, the need for understandability does not allow relevant information to be omitted on the grounds that it may be too difficult for some. *[FRS 102.2.4]*.

3.2.2 Relevance

Relevance is described as the quality of information that allows it to influence the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting their past evaluations. Information provided in financial statements must be relevant to the decision-making needs of users. *[FRS 102.2.5]*.

Where FRS 102 does not specifically address a transaction, other event or condition, Section 10 – *Accounting Policies, Estimates and Errors* – requires an entity's management to use its judgement in developing and applying an accounting policy that results in information that is both relevant to the economic decision-making needs of users and reliable. *[FRS 102.10.4]*.

3.2.3 Materiality

Section 2 states that information is material – and therefore has relevance – if its omission or misstatement, individually or collectively, could influence the economic decisions of users taken on the basis of the financial statements. *Materiality* depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. However, it is inappropriate to make, or leave uncorrected, immaterial departures from FRS 102 to achieve a particular presentation of an entity's financial position, financial performance or cash flows. *[FRS 102.2.6]*.

The ICAEW issued a technical release in June 2008, TECH 03/08 – *Guidance on Materiality in Financial Reporting by UK Entities*, which considers the issue of materiality in financial reporting and is intended to help with the practical application of the definition and explanations of materiality. It describes the determinants of materiality as the size and nature of an item, judged in the particular circumstances of the case.

3.2.4 Reliability

Reliability is defined as the quality of information that makes it free from material error and bias and represents faithfully that which it either purports to represent or could reasonably be expected to represent. Information provided in financial statements must be reliable. Financial statements are not free from bias (i.e. not neutral) if, by the selection or presentation of information, they are intended to influence the making of a decision or judgement in order to achieve a predetermined result or outcome. *[FRS 102.2.7]*.

Where FRS 102 does not specifically address a transaction, other event or condition, Section 10 of FRS 102 requires an entity's management to use its judgement in developing and applying an accounting policy that results in information that is both relevant and reliable. *[FRS 102.10.4]*.

Section 10 of FRS 102 further states that for information to be reliable, financial statements should:

- represent faithfully the financial position, financial performance and cash flows of the entity;
- reflect the economic substance of transactions, other events and conditions and not merely their legal form;
- be neutral, i.e. free from bias;
- be prudent; and
- be complete in all material respects. *[FRS 102.10.4]*.

There may sometimes be a tension between 'neutrality' and 'prudence'. On the one hand, financial statements must be free from bias, i.e. neutral. On the other hand, they must also be prudent, i.e. prepared with a degree of caution such that assets or income are not overstated and liabilities or expenses are not understated. See 3.2.6 below.

'Completeness' is discussed at 3.2.7 below.

3.2.5 Substance over form

Transactions and other events and conditions should be accounted for and presented in accordance with their substance and not merely their legal form. This enhances the reliability of financial statements. *[FRS 102.2.8]*.

Substance over form is also a requirement of UK company law and is required by both *The Large and Medium-sized Companies and Groups (Accounts and reports) Regulations 2008 (SI 2008/410)* (the Regulations) and *The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409)* (the Small Companies' Regulations). *[1 Sch 9, 2 Sch 10, 3 Sch 8, 1 Sch 9 (SC)]*.

3.2.6 Prudence

Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. The uncertainties that will inevitably surround many events and circumstances are acknowledged by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias. *[FRS 102.2.9]*.

For UK companies, the Regulations also require that the amount of any item must be determined on a prudent basis. In particular, only profits realised at the balance sheet date are to be included in the profit and loss account and all liabilities which have arisen in respect of the financial year in which the accounts relate or a previous financial year must be taken into account including those which only become apparent between the balance sheet date and the date on which it is signed on behalf of the board of directors in accordance with section 414 of the Companies Act 2006 (CA 2006). *[1 Sch 13, 2 Sch 19, 3 Sch 18, 1 Sch 13 (SC)]*.

3.2.7 Completeness

To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance. *[FRS 102.2.10]*.

3.2.8 Comparability

Users must be able to compare the financial statements of an entity through time to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities to evaluate their relative financial position, performance and cash flows. Hence, the measurement and display of the financial effects of like transactions and other events and conditions must be carried out in a consistent way throughout an entity and over time for that entity, and in a consistent way across entities. In addition, users must be informed of the accounting policies employed in the preparation of the financial statements, and of any changes in those policies and the effects of such changes. *[FRS 102.2.11]*.

There is more detailed guidance on comparability in Section 10 which requires an entity to select and apply its accounting policies consistently for similar transactions, other events or obligations unless an FRS or FRC Abstract specifically requires or permits categorisation of items for which different policies may be appropriate. *[FRS 102.10.7]*. Section 8 – *Notes to the Financial Statements* – requires an entity to disclose a summary of significant accounting policies, *[FRS 102.8.4(b)]*, and Section 10 requires disclosures where there are changes in accounting policies. *[FRS 102.10.13-14]*.

3.2.9 Timeliness

To be relevant, financial information must be able to influence the economic decisions of users. *Timeliness* means providing the information within the decision time frame. If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the needs of users in making economic decisions. *[FRS 102.2.12]*.

UK companies are required by law to file accounts within specified time limits. For a private company, the period allowed by the CA 2006 for filing financial statements is nine months after the end of the relevant accounting reference period and, for a public company, the period allowed for filing is six months after the end of the relevant accounting reference period. *[s442]*.

3.2.10 Balance between benefit and cost

Section 2 states that the benefits derived from information should exceed the cost of providing it. It is further stated that the evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs are not necessarily borne by those users who enjoy the benefits, and often the benefits of the information are enjoyed by a broad range of external users. *[FRS 102.2.13]*.

Section 2 also asserts that financial reporting information helps capital providers make better decisions, which results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. In the FRC's view, individual entities also enjoy benefits, including improved access to capital markets, favourable effect on public relations, and perhaps lower costs of capital. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for general purpose financial reporting purposes. *[FRS 102.2.14]*.

3.3 Financial position

Section 2 defines the concepts behind the statement of financial position and the statement of comprehensive income. It does not define the concepts behind the other primary statements (the statement of changes in equity and the statement of cash flows).

The *statement of financial position* is a financial statement that presents the relationship of an entity's assets, liabilities and equity as of a specific date. The CA 2006 refers to this financial statement as a balance sheet. *[FRS 102 Appendix I]*.

Assets, liabilities and equity are defined as follows:

- an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity – see 3.3.1 below;

- a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits – see 3.3.2 below; and
- equity is the residual interest in the assets of the entity after deducting all its liabilities – see 3.3.3 below. *[FRS 102.2.15]*.

Some items that meet the definition of an asset or a liability may not be recognised as assets or liabilities in the statement of financial position because they do not satisfy the criteria for recognition – see 3.5 below. In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion before an asset or liability is recognised. *[FRS 102.2.16]*.

In addition, FRS 102 does not generally allow the recognition of items in the statement of financial position that do not meet the definition of assets or liabilities regardless of whether they result from applying the notion commonly referred to as the 'matching concept' for measuring profit or loss – see 3.9.5 below.

3.3.1 Assets

The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. Those cash flows may come from using the asset or from disposing of it. *[FRS 102.2.17]*.

Many assets, for example property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset. Some assets are intangible. *[FRS 102.2.18]*.

In determining the existence of an asset, the right of ownership is not essential. Thus, for example, property held on a lease is an asset if the entity controls the benefits that are expected to flow from the property. *[FRS 102.2.19]*.

3.3.2 Liabilities

An essential characteristic of a liability is that the entity has a present obligation to act or perform in a particular way. The obligation may be either a legal obligation or a constructive obligation. A legal obligation is legally enforceable as a consequence of a binding contract or statutory requirement. A constructive obligation is an obligation that derives from an entity's actions when:

- by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities. *[FRS 102.2.20]*.

The settlement of a present obligation usually involves the payment of cash, transfer of other assets, provision of services, the replacement of that obligation with another obligation, or conversion of the obligation to equity. An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights. *[FRS 102.2.21]*.

3.3.3 Equity

As equity is simply a residual figure, FRS 102 does not require that it be subdivided into any particular components although it is suggested that sub-classifications for a corporate entity may include funds contributed by shareholders, retained earnings and gains or losses recognised in other comprehensive income. *[FRS 102.2.22]*.

However, for a UK company, the balance sheet formats of the Regulations require separate disclosure of various elements of equity. These separate components are: called up share capital; share premium account; revaluation reserve; capital redemption reserve; reserve for own shares; reserves provided by articles of association; fair value reserve, other reserves and the profit and loss account (or retained earnings).

Section 6 – *Statement of Changes in Equity and Statement of Income and Retained Earnings* – requires a reconciliation of each component of equity separately disclosing changes resulting from profit or loss, other comprehensive income and other transactions. An analysis of other comprehensive income by item for each component of equity is also required. *[FRS 102.6.3-3A]*.

3.4 Performance

Performance is described as the relationship of the income and expenses of an entity during a reporting period. FRS 102 permits entities to present performance in a single financial statement (a statement of comprehensive income) or in two financial statements (an income statement and a statement of comprehensive income). *[FRS 102.2.23]*. Section 2 states that total comprehensive income and profit or loss are frequently used as measures of performance or as the basis for other measures, such as return on investment or earnings per share.

Income and expenses are defined as follows:

- income is increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors; and
- expenses are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors. *[FRS 102.2.23]*.

The recognition of income and expenses results directly from the recognition and measurement of assets and liabilities. *[FRS 102.2.24]*. The definition means that any activity which does not increase or decrease an asset or liability cannot be regarded as income or expense unless specifically permitted by a section of FRS 102. Criteria for the recognition of income and expenses are discussed at 3.5 below.

3.4.1 Income

The definition of income (see 3.4 above) encompasses both revenue and gains.

Revenue is income that arises in the course of the ordinary activities of an entity and is referred to by a variety of names including sales, fees, interest, dividends, royalties and rent.

Gains are other items that meet the definition of income but are not revenue. When gains are recognised in the statement of comprehensive income, they are usually displayed separately because knowledge of them is useful for making economic decisions. *[FRS 102.2.25]*.

This split of income between revenue and gains has little meaning for accounting purposes since Section 5 – *Statement of Comprehensive Income and Income Statement* – requires that the format of the income statement should comply with the Regulations (or, where applicable, the LLP Regulations) except to the extent that these requirements are not permitted by any statutory framework under which an entity is required to report. In practice, this means that items of income which result from decreases in liabilities, for example a release of a provision, should be presented in the line item in which the cost was first recognised. *[FRS 102.5.1]*.

3.4.2 Expenses

The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity.

Expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, or property, plant and equipment.

Losses are other items that meet the definition of expenses and may arise in the course of the ordinary activities of the entity. When losses are recognised in the statement of comprehensive income, they are usually presented separately because knowledge of them is useful for making economic decisions. *[FRS 102.2.26]*.

As discussed at 3.4.1 above, this split of expenses between expenses and losses has little meaning for accounting purposes since the format of the income statement is prescribed by the Regulations.

3.5 Recognition of assets, liabilities, income and expenses

Recognition is described as the process of incorporating in the statement of financial position or statement of comprehensive income an item that meets the definition of an asset, liability, equity, income or expense (discussed at 3.9.1 to 3.9.4 below) and satisfies the following criteria:

- it is probable that any future economic benefit associated with the item will flow to or from the entity (see 3.5.1 below); and
- the item has a cost or value that can be measured reliably (see 3.5.2 below). *[FRS 102.2.27]*.

The failure to recognise an item that satisfies these criteria is not rectified by disclosure of the accounting policies used or by notes or explanatory material. *[FRS 102.2.28]*.

3.5.1 The probability of future economic benefit

The concept of probability is used in the first recognition criterion (see 3.5 above) to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence relating to conditions at the end of the reporting period available when the financial statements are prepared. Those assessments are made individually for individually significant items, and for a group for a large population of individually insignificant items. *[FRS 102.2.29]*.

Probability as applicable to recognition in the financial statements is discussed at Section 3.9 below.

3.5.2 Reliability of measurement

The second criterion for the recognition of an item (see 3.5 above) is that it possesses a cost or value that can be measured with reliability. Reliability is discussed at 3.2.4 above.

In many cases, the cost or value of an item is known. In other cases it must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When a reasonable estimate cannot be made, the item is not recognised in the financial statements. *[FRS 102.2.30]*.

An item that fails to meet these recognition criteria may qualify for recognition at a later date as a result of subsequent circumstances or events. *[FRS 102.2.31]*.

Section 2 notes that an item that fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes or explanatory material, or in supplementary schedules. This disclosure is considered appropriate when knowledge of the item is relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements. *[FRS 102.2.32]*. It is not clear what is meant by 'explanatory material' or 'supplemental schedules' since a complete set of financial statements includes only the primary statements and the notes to the financial statements. The notes are described as comprising 'explanatory information', so it seems probable that the explanatory material referred to means explanations given in the notes to the financial statements. *[FRS 102.3.17]*.

3.6 Measurement of assets, liabilities, income and expenses

Measurement is the process of determining the monetary amounts at which an entity measures assets, liabilities, income and expenses in its financial statements. Measurement involves the selection of a basis of measurement. The various sections of FRS 102 specify (or, sometimes, allow a choice of) which measurement basis an entity shall use for many types of assets, liabilities, income and expenses. *[FRS 102.2.33]*.

Two common measurement bases used by FRS 102 are historical cost and fair value. For assets, historical cost is the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire the asset at the time of its acquisition. For liabilities, historical cost is the amount of proceeds of cash or cash equivalents received or the fair value of non-cash assets received in exchange for the obligation at the time the obligation is incurred, or in some circumstances (for example, income tax) the amounts of cash or cash equivalents expected to be paid to settle the liability in the normal course of business. Amortised historical cost is the historical cost of an asset or liability plus or minus that portion of its historical cost previously recognised as an expense or income.

Fair value is the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction. In the absence of any specific guidance provided in a relevant section of FRS 102, where fair value measurement is permitted or required, the guidance in the appendix to Section 2 shall be applied. *[FRS 102.2.34]*. Fair value guidance is discussed at 3.13 below.

Measurement at initial recognition is discussed at 3.10 below and subsequent measurement is discussed at 3.11 below. There is no overriding principle which determines whether historical cost or fair value is the more appropriate method of measurement.

3.7 Pervasive recognition and measurement principles

Section 2 refers to the hierarchy in Section 10 that applies for an entity to follow in deciding on the appropriate accounting policy in the absence of a requirement that applies specifically to a transaction or other event or condition. The third level of that hierarchy requires an entity to look to the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles set out in Section 2. *[FRS 102.2.35]*. The hierarchy is discussed in Chapter 9 at 3.2.

This clarifies that guidance in Section 2 is subordinate to specific requirements in the other sections of FRS 102.

3.8 Accruals basis

Financial statements, except for cash flow information, should be prepared using the accrual basis of accounting. Under the accrual basis, items are recognised as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for those items (see 3.9 below). *[FRS 102.2.36]*.

The definition of the accrual basis is somewhat circular as it means that an item is, for example, recognised as income when it meets the definition and recognition criteria of income. The Regulations require that all income and charges relating to the financial year to which the accounts relate must be taken into account, without regard to the date or receipt of payment. *[1 Sch 14, 2 Sch 20, 3 Sch 19, 1 Sch 14 (SC)]*.

In practice, we do not expect these wording differences to have a material effect as the impact, where applicable, is likely to be similar.

3.9 Recognition in the financial statements

3.9.1 Assets

Section 2 states that an entity shall recognise an asset in the statement of financial position when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably. Conversely, an asset is not recognised in the statement of financial position when expenditure has been incurred for which it is considered not probable that economic benefits will flow to the entity beyond the current reporting period. Instead such a transaction results in the recognition of an expense in the statement of comprehensive income (or in the income statement, if presented). *[FRS 102.2.37]*.

Section 2 repeats the requirements of Section 21 – *Provisions and Contingencies* – that an entity shall not recognise a contingent asset as an asset but, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate. *[FRS 102.2.38]*.

It is clear from the scope of Section 21 that the 'virtually certain' criteria applies only to contingent assets within the scope of that section. Assets arising from financial instruments and executory contracts which are not onerous are not within the scope of Section 21 and the 'probable' criterion applies to the recognition of those assets.

3.9.2 Liabilities

An entity shall recognise a liability in the statement of financial position when:

- the entity has an obligation at the end of the reporting period as a result of a past event;
- it is probable that the entity will be required to transfer resources embodying economic benefits in settlement; and
- the settlement amount can be measured reliably. *[FRS 102.2.39]*.

A contingent liability is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the second or third conditions above. An entity should not generally recognise a contingent liability as a liability (see Chapter 19 at 3.4), except for contingent liabilities of an acquiree in a business combination (see Chapter 17 at 3.7). *[FRS 102.2.40]*.

3.9.3 Income

The recognition of income results directly from the recognition and measurement of assets and liabilities. An entity shall recognise income in the statement of comprehensive income (or in the income statement, if presented) when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. *[FRS 102.2.41]*.

Although this states that the reduction of a liability is regarded as 'income', this does not mean that it should be presented as 'turnover' or 'revenue' in the statement of comprehensive income. The presentation of items in the statement of comprehensive income follows either the statutory formats required by the Regulations or LLP Regulations or the 'adapted formats'. See Chapter 6 at 6.

3.9.4 Expenses

The recognition of expenses results directly from the recognition and measurement of assets and liabilities. An entity shall recognise expenses in the statement of comprehensive income (or in the income statement, if presented) when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. *[FRS 102.2.42]*.

3.9.5 Total comprehensive income and profit or loss

Total comprehensive income is the arithmetical difference between income and expenses. It is not a separate element of financial statements, and a separate recognition principle is not needed for it. *[FRS 102.2.43]*.

Profit or loss is the arithmetical difference between income and expenses other than those items of income and expense that FRS 102 classifies as items of other comprehensive income. It is not a separate element of financial statements, and a separate recognition principle is not needed for it. *[FRS 102.2.44]*.

Generally, FRS 102 does not allow the recognition of items in the statement of financial position that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the 'matching concept' for measuring profit or loss. *[FRS 102.2.45]*.

3.10 Measurement at initial recognition

At initial recognition, an entity shall measure assets and liabilities at historical cost unless FRS 102 requires initial measurement on another basis such as fair value. *[FRS 102.2.46]*.

3.11 Subsequent measurement

3.11.1 Financial assets and financial liabilities

As discussed in Chapter 10 at 8 an entity measures basic financial assets and basic financial liabilities at amortised cost less impairment except for:

- investments in non-derivative instruments that are equity of the issuer (e.g. most ordinary shares and certain preference shares) that are publicly traded or whose fair value can otherwise be measured reliably, which are measured at fair value with changes in fair value recognised in profit or loss; and
- any financial instruments that upon their initial recognition were designated by the entity as at fair value through profit or loss. *[FRS 102.2.47]*.

An entity generally measures all other financial assets and financial liabilities at fair value, with changes in fair value recognised in profit or loss, unless FRS 102 requires or permits measurement on another basis such as cost or amortised cost. *[FRS 102.2.48]*.

3.11.2 Non-financial assets

Most non-financial assets that an entity initially recognised at historical cost are subsequently measured on other measurement bases. For example, as discussed in Chapter 15 at 3.5 and 3.6, an entity measures property, plant and equipment using either the cost model or the revaluation model and an entity measures inventories at the lower of cost and selling price less costs to complete and sell.

Measurement of assets at amounts lower than initial historical cost is intended to ensure that an asset is not measured at an amount greater than the entity expects to recover from the sale or use of that asset. *[FRS 102.2.49]*.

For certain types of non-financial assets, FRS 102 permits or requires measurement at fair value. For example:

- investments in associates and joint ventures that an entity measures at fair value (see Chapters 12 and 13);
- investment property that an entity measures at fair value (see Chapter 14);
- biological assets that an entity measures at fair value less estimated costs to sell in accordance with the fair value model and agricultural produce that an entity measures, at the point of harvest, at fair value less estimated costs to sell in accordance with either the fair value model or cost model (see Chapter 31);
- property, plant and equipment that an entity measures in accordance with the revaluation model (see Chapter 15); and
- intangible assets that an entity measures in accordance with the revaluation model (see Chapter 16). *[FRS 102.2.50]*.

3.11.3 Liabilities other than financial liabilities

Most liabilities other than financial liabilities are measured at the best estimate of the amount that would be required to settle the obligation at the reporting date. *[FRS 102.2.51]*.

This wording is identical to that required for provisions by Section 21 which provides additional explanatory guidance. *[FRS 102.21.7]*. See Chapter 19.

3.12 Offsetting

An entity shall not offset assets and liabilities, or income and expenses, unless required or permitted by FRS 102. However, measuring assets net of valuation allowances (for example, allowances for inventory obsolescence and allowances for uncollectible receivables) is not offsetting. *[FRS 102.2.52]*.

If an entity's normal operating activities do not include buying and selling fixed assets, including investments and operating assets, then the entity reports gains and losses on disposal of such assets by deducting from the proceeds on disposal the carrying amount of the asset and related selling expenses. *[FRS 102.2.52]*.

This implies that no recycling of unrealised gains from a revaluation reserve within equity to profit and loss is generally permitted by FRS 102, though the gain becomes realised at the point of disposal. A reserves transfer from the revaluation reserve to retained earnings within the statement of changes in equity would be recorded. However, such recycling is permitted for the following:

- financial instruments held at available for sale, under the provisions of IAS 39 – *Financial Instruments: Recognition and Measurement* – that can be applied under Section 12 – *Other Financial Instruments Issues* – of FRS 102; *[FRS 102.12.2]*
- debt instruments carried at fair value through other comprehensive income, under the provisions of IFRS 9 – *Financial Instruments*, that can be applied under Section 12 – *Other Financial Instruments Issues* – of FRS 102; *[FRS 102.12.2]* and
- the effective portion of gains and losses on hedging instruments in a cash flow hedge. *[FRS 102.12.23, IFRS 9.6.5.11]*.

3.13 Fair value

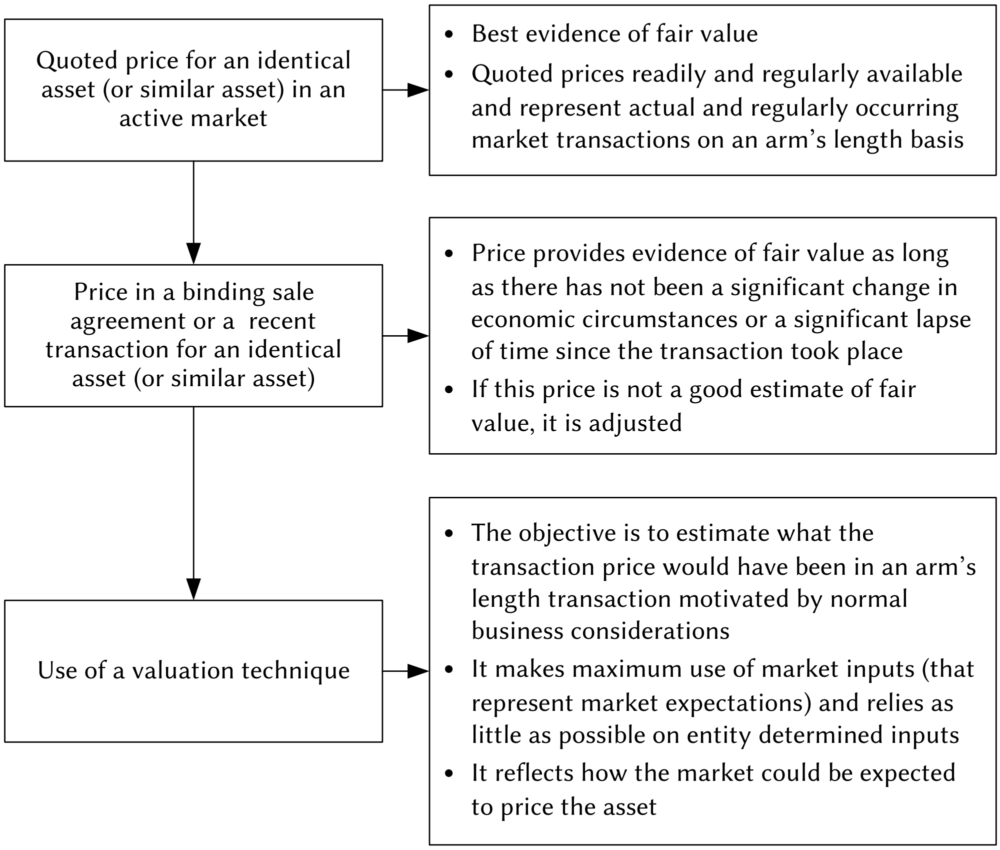
FRS 102 defines fair value as the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction. FRS 102 goes on to say that, in the absence of any specific guidance provided in the relevant section of this FRS, the guidance in the Appendix to Section 2 should be used in determining fair value. *[FRS 102 Appendix I]*.

This definition of fair value is similar to that found in the version of IAS 39 prior to issuance of IFRS 13 – *Fair Value Measurement* – and appears to be based on the notion of an 'entry price'. This is made explicit by the explanation that the best evidence is usually the current bid price. The definition differs from that in IFRS 13 which defines fair value as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'. *[IFRS 13.9]*. The IFRS 13 definition is therefore based on an exit price. The difference in definitions could lead to different measurements of fair values, in particular for financial liabilities as the amount to settle a liability required by FRS 102 to determine fair value may differ from the amount paid to transfer the same liability, which is the definition of fair value under IFRS 13 (see Chapter 10 at 8.6).

3.13.1 Hierarchy used to estimate fair value of shares

As mentioned above, the key guidance on how to calculate fair values is contained in the appendix to Section 2. The guidance sets out a hierarchy to estimate fair value for which the best evidence of fair value is a quoted price for an identical asset (or similar asset) in an active market. *[FRS 102.2A.1]*. Figure 4.1 below shows the fair value hierarchy to be used.

Figure 4.1: Hierarchy



Reporting entities should measure fair value using the highest available level within the hierarchy. Section 2 is explicit that the best evidence of fair value is a quoted price for an identical (or similar) instrument in an active market and it is only when such quoted prices are unavailable, does an entity use the price in a binding sale agreement or a recent transaction for an identical (or similar) instrument and failing that, a valuation technique. *[FRS 102.2A.1, 29]*. However, the above guidance is somewhat theoretical and no examples are provided to illustrate its application, nor does the Basis for Conclusions shed any further light.

3.13.2 Quoted price in an active market

'Active market' is defined as 'a market in which all the following conditions exist:

(a) the items traded in the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.' *[FRS 102 Appendix I]*.

Based on the above definition, most equities and bonds that are listed on an exchange for which there is a liquid secondary market in terms of regular trading will be considered to be traded in an active market. In addition, instruments that are frequently traded in over-the-counter markets (i.e. instruments that are not listed on an exchange), such as interest rate swaps and options, foreign exchange derivatives and credit default swaps, and for which there are available quotes may also be captured if closing prices are published.

Section 2's requirement, that the best evidence of fair value is a quoted price for an identical or similar asset in an active market, is similar to that in IFRS 13. However, FRS 102 does not reproduce the additional guidance contained in IFRS 13 that the fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price, known as 'p times q'. *[IFRS 13.80]*. This guidance means that an entity which has a very large holding of an actively traded financial instrument is unable to adjust the quoted price to reflect any discount or premium that might arise if the holding were to be unloaded onto the market. Given that this guidance is not contained in FRS 102, some might read it as not to require the use of p times q in these circumstances.

3.13.3 Price in a binding sale agreement or recent transaction

The use of the price of a binding sale agreement or recent transaction for an identical instrument is a simple valuation technique. However, what requires some judgement is determining whether that price is representative of fair value or not. An adjustment is required if the last transaction is not a good estimate of fair value. This could be the situation if there has been a significant change in economic circumstances, a significant period of time between the date of the binding sale agreement or the transaction and the measurement date or the price of the transaction reflects an amount that an entity was forced to pay or receive in a forced transaction, involuntary liquidation or distressed sale. *[FRS 102.2.2A.1]*.

3.13.4 Other valuation techniques

In addition to the use of the price of a recent transaction for an identical (or similar) instrument, other valuation techniques could include reference to the current fair value of another instrument that is substantially the same as the instrument being measured, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the asset and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. *[FRS 102.2.2A.2]*.

The objective of using a valuation technique is to determine what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Fair value should be established using a valuation technique which makes maximum use of market inputs (i.e. inputs external to the entity) and relies as little as possible on entity-determined inputs. A reliable estimate would be achieved by a valuation technique which reasonably reflected how the market could be expected to price the asset and the inputs to the valuation should reasonably represent market expectations and measures of the risk return factors inherent in the asset. *[FRS 102.2A.3]*.

Many entities applying FRS 102 will not enter into instruments that are required to be recorded at fair value through profit or loss and for which a quoted price in active markets is not available. However if they do invest in, or issue complex instruments that must be fair valued but do not have quoted prices in active markets, they may have to draw upon the larger body of guidance within IFRS 13 in making judgements regarding how to measure fair value, especially regarding the use of valuation techniques. Further information regarding IFRS 13 can be found in Chapter 14 of EY International GAAP 2019.

3.13.4.A Consideration of own credit risk

Although guidance in IFRS 13 on valuation techniques may be helpful in some circumstances, caution should be taken in applying the guidance. For instance, IFRS 13 is clear that entities must include in the fair value of financial liabilities such as derivatives any changes in fair value attributable to their own credit risk. *[IFRS 13.42]*. This has the unintuitive consequence that such entities will record profits on revaluation when their credit risk increases. FRS 102 contains no specific equivalent recognition or measurement requirement, unless the option has been chosen to apply IFRS 9, although entities are required to disclose the effect of own credit risk on liabilities recorded at fair value through profit or loss (see Chapter 10 at 11.2.2) for those financial liabilities that do not form part of a trading book and are not derivatives. This could be interpreted to imply that fair value for such liabilities should include the effects of changes in own credit risk; however, since FRS 102 determines that fair value of a liability should be measured on a settlement basis rather than at the amount paid to transfer it (see Chapter 10 at 8.6.4.A), the consideration of own credit risk would be an accounting policy choice.

3.13.5 Fair value not reliably measurable

For assets that do not have a quoted market price in an active market, fair value is considered reliably measurable when the range of reasonable fair value estimates is not significant or the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. *[FRS 102.2A.4]*. No further guidance is provided to assess significance or probabilities in this context, hence, entities will need to exercise judgement. However, we believe that the bar for determining that a fair value measurement is not reliably measurable is relatively high as there is an expectation that it is normally possible to estimate the fair value of an asset that an entity has acquired from an outside party. *[FRS 102.2A.5]*. Therefore situations in which the range of reasonable estimates is significant and the probabilities of those estimates cannot be reasonably be assessed will be limited to investments such as equity holdings in private companies, for which the investee has no comparable peers.

If a reliable measure of fair value is no longer available for an asset measured at fair value, it must use as its new cost the carrying amount at the last date when the fair value was reliably measurable as its new cost. The asset will then be carried at cost less impairment, until a reliable measure of fair value becomes available again. *[FRS 102.2A.6]*.

3.13.6 Financial liabilities due on demand

The fair value of a financial liability that is due on demand is deemed to be not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. *[FRS 102.12.11]*. The logic is that a rational lender would demand repayment if the fair value were ever less than the net present value of the amount repayable, even though in practice many people do not withdraw their demand deposits in such circumstances. No guidance is provided in this context as to the appropriate discount rate, although the guidance on financing transactions would be appropriate (see Chapter 10 at 7.2). The requirement about the manner of measuring the fair value of a financial liability with a demand feature is identical to that in paragraph 47 of IFRS 13, hence, further information can be found in Chapter 14 of EY International GAAP 2019.

References

1 *The Conceptual Framework for Financial Reporting (Conceptual Framework)*, IASB, paras. 2.5-34.
2 *Conceptual Framework,* IASB, paras. 1.22-23.
3 *Stewardship/Accountability As An Objective of Financial Reporting: A Comment on the IASB/FASB Conceptual Framework Project*, ASB, EFRAG and others, June 2007.

Chapter 5 FRS 102 – Small entities

List of examples

Chapter 5 FRS 102 – Small entities

1 INTRODUCTION

1.1 Background

Company law changes implementing the Accounting Directive (Directive 2013/34/EU), which had mandatory effect for financial years beginning on or after 1 January 2016, necessitated changes to the accounting framework for small entities. UK company law changes implementing the Accounting Directive were principally made by *The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015* (SI 2015/980) (for UK companies and qualifying partnerships) and were extended to LLPs by *The Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016* (SI 2016/575).

In July 2015, the FRC issued FRS 105 – *The Financial Reporting Standard applicable to the Micro-entities Regime* – and introduced a new small entities regime, Section 1A – *Small Entities* – into FRS 102 – *The Financial Reporting Standard applicable in the UK and Republic of Ireland.* FRS 105 and Section 1A of FRS 102 are effective for accounting periods beginning on or after 1 January 2016 (with certain early application provisions).

Section 1A of FRS 102 requires small entities to apply the recognition and measurement requirements of FRS 102 in full. However, the presentation and disclosure requirements of Section 1A are based on the requirements of the CA 2006 and *The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008* (SI 2008/409), as amended ('the Small Companies Regulations'), for companies subject to the small companies regime. In particular, Appendix C to Section 1A of FRS 102 closely reflects the UK company law disclosure requirements for small companies.

Following changes made to Irish law to implement the Accounting Directive, the small entities regime in Section 1A also became available to entities in the Republic of Ireland. In December 2017, *Amendments to FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland – Triennial Review 2017 – Incremental improvements and clarifications* (Triennial review 2017) – amended Section 1A of FRS 102, principally to reflect the changes made to Irish law. See 4.5 below.

FRS 100 – *Application of Financial Reporting Requirements* – and FRS 102 (see Chapter 1 at 4.4 and Chapter 3 at 2.1) set out the accounting framework for preparation of an entity's financial statements, as follows: *[FRS 100.4, FRS 102.1A.1-2, FRS 102.1.3]*

- entities that are eligible to apply the micro-entities regime may apply FRS 105;
- other entities (that are not required to apply EU-adopted IFRS) have a choice of applying EU-adopted IFRS, FRS 101 – *Reduced Disclosure Framework: Disclosure exemptions from EU-adopted IFRS for qualifying entities* (individual financial statements of a qualifying entity only), or FRS 102; and
- an entity qualifying for the small entities regime that adopts FRS 102 can choose to apply Section 1A or the full standard.

Micro-entities applying the micro-entities regime in the UK or Republic of Ireland must apply FRS 105. *[FRS 105.1.4-4A]*. See Chapter 1 at 6.4.

1.2 Scope of this chapter

This chapter principally addresses the requirements of Section 1A and the related company law requirements (for companies subject to the small companies regime) and the related LLP law requirements (for LLPs subject to the small LLPs regime).

While Section 1A can now be used by small entities in the Republic of Ireland ('Irish small entities'), this chapter does not discuss in detail the qualifying criteria for an Irish small entity, nor the presentation and disclosure requirements of Irish law and Section 1A specific to Irish small entities. However, an outline of the changes to Irish law made in 2017 to introduce a small companies regime is included at 4.5 below. The disclosure framework for Irish small entities (set out in a new Appendix D to Section 1A, which largely mirrors Appendix C for UK companies) is briefly discussed at 11.6 below.

References in this chapter to FRS 100 to FRS 102 are to those accounting standards, as amended by the Triennial review 2017, i.e. the compendium versions of those standards issued in March 2018. The changes made by the Triennial review 2017 relevant to small entities are summarised at 1.3 below.

A summary of Section 1A is included at 2 below, and its content is discussed at 6 to 11 below. Key definitions used in this chapter are included at 3 below. The effective dates of Section 1A (and the amendments made to this section by the Triennial review 2017) are discussed at 5 below.

A company subject to the small companies regime (in the UK or Republic of Ireland), an LLP subject to the small LLPs regime, and an entity that would have qualified for the small companies regime had it been a company, are permitted to use Section 1A. *[s382-s384, s382 (LLP)–s384 (LLP), FRS 102 Appendix I]*. See the definition of a 'small entity' at 3 below. The qualifying criteria for UK companies and LLPs are discussed at 4 below.

UK companies subject to the small companies regime apply the Small Companies Regulations and are eligible for certain disclosure exemptions in the CA 2006. Similarly, LLPs subject to the small LLPs regime apply the Small LLP Regulations (as amended) and are eligible for certain disclosure exemptions in the CA 2006 as applied to LLPs. In general, the Small Companies Regulations and Small LLP Regulations contain considerably fewer disclosures than the Regulations and LLP Regulations. Financial statements of a UK company prepared in accordance with FRS 102 are Companies Act accounts. The disclosures required in Companies Act accounts for companies subject to the small companies regime (which have been largely included in Appendix C of Section 1A) are set out at 11 below. Some differences for small LLPs are discussed at 11.5 below.

The presentation requirements of full FRS 102 that are mandatory for entities applying Section 1A are covered in 7 below. These include the overriding requirement for the financial statements to give a true and fair view. If a small entity chooses not to apply Section 1A (or presents additional primary statements), refer to Chapter 6 which addresses the presentation requirements of full FRS 102.

FRS 102 includes transition exemptions for small entities (see 6.4 below). However, these only apply for small entities adopting FRS 102 for accounting periods beginning before 1 January 2017. FRS 102 also exempts small entities from preparing a cash flow statement (see 7.1 below) and provides a concession in accounting for certain loans from a director or his / her close family member (see 6.3 below). These exemptions are available to a small entity, whether or not Section 1A is applied.

This chapter has been cross referred from Chapter 1 (which discusses FRS 100) because it includes the qualifying criteria for the small companies regime and the small LLPs regime. The qualifying criteria apply to companies and LLPs preparing Companies Act accounts (non-IAS accounts, for an LLP) or IAS accounts.

The statutory disclosure and filing exemptions for:

- the financial statements of UK companies and LLPs, prepared in accordance with the small companies regime and small LLPs regime respectively; and
- the reports of UK companies taking advantage of the small companies exemption

are discussed at 12 and 13 below.

The disclosure exemptions available in the financial statements of companies subject to the small companies regime differ for Companies Act accounts and IAS accounts. Companies Act accounts include financial statements prepared in accordance with FRS 101, FRS 102 and FRS 105. However, the micro-entity provisions (which apply to financial statements prepared in accordance with FRS 105 by a UK company or LLP) are addressed in Chapter 1 at 6.4 rather than this chapter.

1.3 Changes made by the Triennial review 2017

The main changes made by the Triennial review 2017 to Section 1A are to add Irish legal references and a new Appendix D, which sets out the disclosure requirements for Irish small entities and closely follows the statutory requirements in the Republic of Ireland.

Other changes are to refer to the small LLPs regime (which post-dated the July 2015 amendments to FRS 102 that introduced Section 1A) or are mainly clarifications.

In addition, Appendix III – *Note on legal requirements* – to FRS 102 has been updated to reflect the changes to LLP law made by SI 2016/575, *[FRS 102 Appendix III.43]*, and a new Appendix IV – *Republic of Ireland legal references* – has been added (reflecting the changes to Irish law in 2017). *[FRS 102 Appendix IV]*.

2 SUMMARY OF SECTION 1A (AND RELATED CA 2006 REQUIREMENTS)

- Section 1A sets out accounting requirements for entities subject to the small entities regime (see 4 below), whether or not they report under the CA 2006 (or for small entities in the Republic of Ireland, the Companies Act 2014).
- Section 1A can be applied by a company qualifying for the small companies regime in the UK (see 4.3 below) or in the Republic of Ireland (see 4.5 below), an LLP qualifying for the small LLPs regime (see 4.4 below), or an entity that would have qualified for the small companies regime had it been a company incorporated under company law. The effective date for when small entities in the UK and Republic of Ireland can apply Section 1A differs, as explained at 5 below.
- Section 1A is optional and small entities can choose to apply full FRS 102.
- SORPs may include more restrictive provisions. For instance, it is generally understood that the Charities SORP (FRS 102),[1] as amended by *Charities SORP – FRS 102 Update Bulletin 1 (February 2016)* ('Update Bulletin 1') and *Charities SORP – FRS 102 Update Bulletin 2 (October 2018)* ('Update Bulletin 2'), does not allow charities within its scope to apply Section 1A (see 4.2 below). The Statement of Recommended Practice – *Accounting by Limited Liability Partnerships (January 2017)* – also requires small LLPs to make some additional disclosures in their financial statements, as explained at 11.5 below.
- Section 1A requires that small entities apply the recognition and measurement requirements of FRS 102 in full (see 6 below) and exempts small entities from most of the existing presentation requirements of FRS 102 (although the general principles concerning the presentation of financial statements, such as the requirement for the financial statements to show a true and fair view, still apply – see 7 below).
- Where Section 1A is applied by a small entity, a complete set of financial statements comprises: a statement of financial position, an income statement, and notes. Small entities are encouraged to but are not required to present a statement of comprehensive income, or statement of changes in equity (or statement of income and retained earnings). See 8 below.
- Small entities applying FRS 102 are not required to prepare a cash flow statement (even if they do not apply Section 1A). However, small charities with gross income exceeding £500,000 (or €500,000 in the Republic of Ireland) are required by the Charities SORP (FRS 102) to prepare a cash flow statement. See 4.2 and 7.1 below.
- Section 1A requires the statement of financial position and income statement to be presented in accordance with Part 1 of Schedule 1 to the Small Companies Regulations or Part 1 of Schedule 1 to the Small LLP Regulations (which permit the use of abridged formats, adapted formats or statutory formats). Irish small entities refer instead to Part II of Schedule 3A to the Companies Act 2014. Irish law does not permit use of abridged formats. See 8 to 10 below.
- Small entities in the UK must provide the disclosures set out in Appendix C to Section 1A, which are based on the statutory disclosures in the CA 2006 and the Small Companies Regulations for companies subject to the small companies regime. Appendix C covers the vast majority of statutory disclosures applicable to

individual accounts of companies subject to the small companies regime. In the small number of cases where the disclosures in Section 1A and the statutory disclosures for LLPs differ, LLPs should apply the equivalent disclosures required by the Small LLP Regulations rather than those in Appendix C of Section 1A. Irish small entities should instead provide the disclosures set out in Appendix D to Section 1A, which are based on the statutory disclosures in the Companies Act 2014. See 11 below.

- Financial statements prepared by small entities are required to give a true and fair view; consequently, additional disclosures beyond those specifically mandated may be required (see 7.2, 8 and 11 below). Appendix E to Section 1A sets out additional disclosures specifically encouraged for small entities. See 11.3 below.
- Section 1A does not require a small entity that is a parent entity to prepare consolidated financial statements. Section 1A sets out requirements for consolidated financial statements, where prepared. However, changes to UK company law, effective for financial years beginning on or after 1 January 2017, mean that some UK companies eligible for the small companies regime may be required to prepare consolidated financial statements. See 6.2 below.

3 KEY DEFINITIONS AND ABBREVIATIONS

See Chapter 6 at 3.1 for relevant definitions.

In addition, definitions relevant to qualification for the small companies regime (and the small LLPs regime) are included at 4 below.

The terms 'Irish small entities' and 'small entities in the Republic of Ireland' mean the same and are used interchangeably.

References to the 'General Rules to the formats' mean the 'General Rules', as included in Section A of Part 1 of Schedule 1 to the Small Companies Regulations or the equivalent requirements in the Small LLP Regulations.

The following statutory instruments are referred to by their statutory instrument number:

- *The Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008* (SI 2008/1911). This statutory instrument sets out how Parts 15 and 16 of the Companies Act 2006 apply to LLPs and is also referred to as 'the CA 2006 as applied to LLPs'.
- *The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015* (SI 2015/980). This statutory instrument implemented the Accounting Directive (Directive 2013/34/EU) and made significant amendments to the small companies regime.
- *The Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016* (SI 2016/575). This statutory instrument made significant amendments to the small LLPs regime.

References to 'LLP SORP' are to The Statement of Recommended Practice – *Accounting by Limited Liability Partnerships* (January 2017) – issued by the Consultative Committee of Accountancy Bodies (CCAB).