FRSSE
update

BWMacfarlane
CHARTERED ACCOUNTANTS

FRSSE update for micro-entity reporting

A guide for clients

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We have tried to keep this non technical as far as possible but if you want to discuss it further please do ring your normal relationship manager or partner. The Financial Reporting Council (FRC) amended the FRSSE micro-entities accounts for financial years ending on or after 30 September 2013, filed on or after 1 December 2013.

Financial reporting in the UK is undergoing a substantial period of change, most notably with the introduction of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* for accounting periods commencing on or after 1 January 2015 and also small company financial reporting changes.

This micro-entities legislation allows qualifying companies to take advantage of certain exemptions in the preparation of their financial statements.

Financial statements prepared under the micro-entities regime are 'presumed' to give a true and fair view.

A company qualifies as a micro-entity in a year in which it does not exceed two or more of the following criteria:

- Turnover £632,000
- Gross assets £316,000
- Employees 10

The above conditions must be met for two consecutive years (with the exception of a newly incorporated company) and where a company does not meet the conditions for two consecutive years it must cease to be a micro-entity.

Example- qualification not met in the current period

A company qualifies for micro-entity classification in the previous accounting period. However, in the current accounting period the company no longer meets the criteria.

In this instance, the company may continue to claim the exemptions available in the current period. If, in the succeeding accounting period the company reverts back to meeting the criteria, the exemptions will continue uninterrupted.

The micro-entities' legislation will not apply to:

- Certain financial institutions (for example investment undertakings and credit institutions)
- Companies that voluntarily prepare consolidated financial statements (and those entities included in consolidated financial statements); and
- Limited liability partnerships.

Amendments

The FRSSE has a new paragraph that in essence says a micro-entity preparing its financial statements must disregard all the presentation and disclosure requirements contained in the FRSSE (and this includes the formats for both the balance sheet and profit and loss account), but still apply those paragraphs which relate to financial statement formats and the notes which only apply to micro-entities.

Example- additional disclosures

A company qualifies for micro-entity but chooses to provide additional disclosures, it should follow the FRSSE treatment for that item.

Micro-entities preparing financial statements based on the minimum accounting items specific to such entities can only apply the specific paragraphs of the FRSSE that apply to micro-entities. The intention here is to let micro-entities take advantage of the reduced presentation and disclosure requirements while still complying with the recognition and measurement requirements of the FRSSE (although the amended FRSSE simplifies the recognition and measurement of fixed assets and investments for micro-entities).

Accounting policy amendments

There are also some new accounting policy issues that relate only to micro-entities:

- Micro-entities will not be able to adopt the revaluation model in respect of tangible fixed assets
- Fixed asset investments will not be measured at market value
- Investment properties will be carried under normal fixed asset rules (ie cost less depreciation and impairment instead of fair value); and
- Current asset investments will no longer be measured at current cost.

Example- change in accounting policy

A company that qualifies as a micro-entity revalued in accordance with the FRSSE and has now chosen to report under the micro-entities legislation.

As the company will not be able to adopt the revaluation model it must account for the building at cost less depreciation and impairment. This will be a change in accounting policy and therefore the amounts for the current and corresponding periods must be restated on the basis of the new accounting policy.

If, on the other hand, the company wished to continue reporting under the revaluation model it could continue using the small companies' regime (and report under 'full' FRSSE) as the micro-entities regime is not mandatory.

Problems could arise with this accounting policy change as a previous revaluation amount cannot be used as “deemed cost” where a micro-entity previously carried tangible fixed assets under the revaluation model. The micro-entities regime only allows micro-entities to use historical cost accounting rules and these require fixed assets to be recognised at purchase price or production cost. So using a previous revaluation would give rise to inconsistencies with the new legislation for micro-entities.

Financial statement presentation

Under the micro-entities legislation, the balance sheet can be prepared under Format 1 or Format 2 as follows:

<u>Balance sheet - Format 1</u>

A. Called up share capital not paid
B. Fixed assets
C. Current assets
D. Prepayments and accrued income
E. Creditors: amounts falling due within one year
F. Net current assets (liabilities)
G. Total assets less current liabilities
H. Creditors: amounts falling due after more than one year
I. Provisions for liabilities
J. Accruals and deferred income
K. Capital and reserves

<u>Balance sheet - Format 2</u>

Assets
A. Called up share capital not paid
B. Fixed assets
C. Current assets
D. Prepayments and accrued income

Liabilities
A. Capital and reserves
B. Provisions for liabilities
C. Creditors*
D. Accruals and deferred income
*creditors due within and after more than one year should be shown separately.

The profit and loss account can only be prepared under Format 2 as follows:

A. Turnover
B. Other income
C. Cost of raw materials and consumables
D. Staff costs
E. Depreciation and other amounts written off assets
F. Other charges
G. Tax
H. Profit or loss

Notes to the financial statements

Micro-entities must include notes at the foot of the balance sheet which provide disclosure of:

- Guarantees and other financial commitments as follows:

  - Charges on the assets of the company to secure third party liabilities and, where practicable, the amount secured

  - Other contingent liabilities not provided for showing the amount (or estimate) of that liability; its legal nature and whether any valuable security has been provided and, if so, what

  - Aggregate, or estimated, amount of contracts for capital expenditure unprovided for (where practicable)

  - Particulars of any pension commitments which relate wholly or in part to pensions payable to past directors of the company as far as it relates to such pensions

  - Financial commitments that have not been provided for and are relevant in assessing the state of the entity's affairs

  - Any commitments in the sub-bullets above which are undertaken on behalf or, or for the benefit of, a parent company, fellow subsidiary or any subsidiary of the parent. These must also be disclosed separately from other commitments.

- Directors' benefits: advances, credits and guarantees as follows:

  - Details relating to advances and credits granted by the company to its directors as well as details of guarantees of any kind entered into by the company on behalf of the directors

  - In respect of advances or credits, particulars of its amount; indication of the interest rate; main conditions and any amounts repaid

- For guarantees, particulars of its main terms; amount of the maximum liability that the company may incur and any amount paid/liability incurred by the company for the purposes of fulfilling the guarantee (this also extends to any losses incurred for the enforcement of the guarantee)

- Totals relating to the amount of advances or credits and any amounts repaid; the amount of the maximum liability that may be incurred by the company in respect of a guarantee and any amount paid/liability incurred by the company for the purposes of fulfilling the guarantee together with any loss incurred for the enforcement of the guarantee.

The requirements relating to directors' benefits such as advances, credit and guarantees relate to any person who was a director at any time during the financial year and apply to every advance, credit or guarantee subsisting at any time in the financial year to which the accounts relate, whenever it was entered into and whether or not the person concerned was a director of the company at the time it was entered into.

There are other considerations when deciding whether to continue to file abbreviated accounts or changing format to micro-entity accounts:

1. Whilst the accounts prepared under the new regulations are greatly simplified from the perspective of presentation, the profit and loss account and balance sheet have few details; the directors' report will state little more than the names of the directors; and only two notes to the accounts are required. But much of the effort that goes into preparing a set of accounts centres on the preparation of financial data in accordance with accounting principles. This will not go away and the only time saved is in the presentation. In other words, while the reporting output is certainly lighter, the work required in preparing the results reported in the accounts is largely unchanged.

2. Detailed information on the financial health of the business will still be needed to secure funding from sources such as the banks. Even if there is no immediate plan to seek investment, a business might want to disclose more information than the regulations suggest, in order to maintain its good credit rating.

3. As always, the accounts must give a true and fair view of the business. It is possible that if the client presents only the 'highlights', with the bare minimum of data, they may put themselves at greater risk of an investigation by HMRC.

These considerations can be discussed on a case by case basis.

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FOR GENERAL INFORMATION ONLY
Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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