Chapter 1 FRS 100 – Application of financial reporting requirements

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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*

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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.

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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':

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- *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'.

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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.

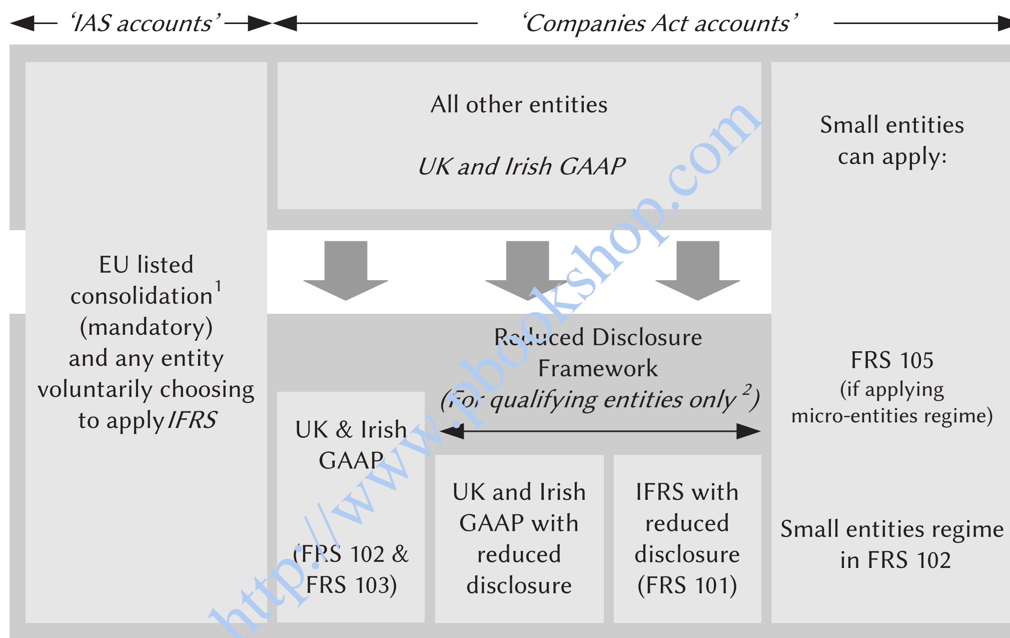
In developing the new standards, the FRC has set out an overriding objective to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. *[FRS 100.BC.1]*.

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



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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.

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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]*.

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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.

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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.

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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.

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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.

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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

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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

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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.

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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.

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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.

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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

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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.

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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)]*.

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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.

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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

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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.

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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.

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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.

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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.

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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.

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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]*.

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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

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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

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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.

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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)

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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).

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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.

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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.

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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.

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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

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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)]*.

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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.

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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.

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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.

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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 GC100 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

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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

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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.

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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.

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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

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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

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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.

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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.

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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.

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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

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