FRS 102 and FRS 105 Example small and micro company accounts

Presented by

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Contents of Notes in Order of Presentation

Section 1: Preparing accounts under the new small and micro company regimes

All accountancy firms should now be aware of the demise of the Financial Reporting Standard for Smaller Entities (the FRSSE) for accounting periods starting on or after 1 January 2016 and firms should, at this stage in the process, be in the realms of preparing for the transition.

While firms will rely on automated accounts production software systems, it is important to understand the impact of the new reporting regimes on the responsibilities of the directors.

Section 393, Companies Act 2006

Section 393 of the Companies Act 2006 prohibits directors from approving financial statements which do not give a true and fair view. The concept of 'true and fair' is retained for small companies and hence small company directors have a legal obligation to ensure that the financial statements give a true and fair view.

The Companies Act 2006 was revised to incorporate the provisions of the EU Accounting Directive and many small companies will prepare financial statements under the revised Act for accounting periods starting on or after 1 January 2016 (i.e. 31 December 2016 year-ends), although early-adoption of the revised legislation is permitted.

While the provisions in the revised Companies Act 2006 reflect the EU Accounting Directive, there has been no change to the requirement to produce true and fair financial statements. However, this is not the case for micro-entities due to the 'deeming provisions' which state that where a micro-entity prepares its accounts to the minimum requirements laid down in law, those financial statements are *presumed* to give a true and fair view.

Impact of the revised Companies Act 2006 on directors and advisers

The overarching objective of the Accounting Directive is to reduce the burdens placed on small companies (and micro-entities) in the preparation of their annual accounts. The Directive reduces the disclosure requirements, but in practice this will not always be 'plain-sailing'.

As mentioned above, the requirement to prepare financial statements that give a true and fair view is retained for small companies by virtue of section 393. The mere application of the legally required disclosures outlined in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* at Section 1A *Small Entities*, Appendix C *Disclosure requirements for small entities* may not be enough to achieve a true and fair view. In such situations, the directors will be required to determine the disclosures that are needed in the financial statements to achieve a true and fair view and make those disclosures in accordance with the relevant section(s) of FRS 102 dealing with the type of disclosure(s) needed.

There is little in the way of guidance as to what small company directors can do where additional disclosures are required; although the Financial Reporting Council (FRC) have published a document called True and Fair which may assist directors and their advisers. It is clear, therefore, that the reduction in disclosure requirements brought about by the Accounting Directive is going to mean more responsibilities are placed on the directors of small companies who, in practice, will rely on their accountants to assist (although care should be taken where the professional accountancy firm also acts in the capacity as auditor).

The FRC have included Appendix D *Additional disclosures encouraged for small entities* in Section 1A of FRS 102; although Appendix D only encourages, rather than mandates, these additional disclosures because the FRC cannot insist on small companies making anymore disclosures than those required by law. However, where the small company is materially affected by any of the encouraged disclosures outlined in Appendix D and it does not make the required disclosures, it will be very difficult to justify how the financial statements give a true and fair view. This may cause issues to be raised by professional body regulators (such as ICAEW's Quality Assurance Department and ACCA Monitoring Officers) as well as HM Revenue and Customs that employ a team of technical accountants that review financial statements submitted to them by companies.

The key message being sent out by FRC and professional bodies is that it is now more important than ever that professional accountants ensure that the financial statements of small companies **give a true and fair view**. Professional accountants should not adopt the attitude of 'if it is not in the legislation, it does not need disclosure' because the requirement for small companies to prepare true and fair accounts has not changed. If a professional accountant does not make sure that the financial statements give a true and fair view, the scope for professional negligence claims is inherently higher (something which all practitioners need to avoid at all costs).

The encouraged disclosures

There are five encouraged disclosures for small entities outlined in Appendix D of Section 1A of FRS 102, as follows:

a) a statement of compliance with this FRS as set out in paragraph 3.3, adapted to refer to Section 1A;
b) a statement that it is a public benefit entity as set out in paragraph PBE3.3A;
c) the disclosures relating to going concern set out in paragraph 3.9;
d) dividends declared and paid or payable during the period (for example, as set out in paragraph 6.5(b)); and
e) on first-time adoption of this FRS an explanation of how the transition has affected its financial position and financial performance as set out in paragraph 35.13.

Illustrative financial statements of a small company

The following illustrative financial statements are not a comprehensive model of how the financial statements of a small entity reporting under FRS 102, Section 1A should look. Indeed, as mentioned above, disclosures over and above those required by Section 1A will often need to be made in order that the financial statements give a true and fair view.

These example financial statements have been prepared to show the requirements of company law as amended by SI 2015/980 The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 and Section 1A *Small Entities* of FRS 102, issued September 2015
FRS 102 applies to small companies applicable for periods commencing on or after 1 January 2016. Early application of these requirements is permitted for periods commencing on or after 1 January 2015

Smallco Ltd
Company information
For the year ended 30 June 2017

Company registration number	99999999
Directors	J Smith B Jones
Registered office	987 Low Street Anytown AB1 2CD
Solicitor	Legal Eagles LLP 9 Legal Towers Anytown AB2 3EF
Bankers	National Bank PLC Anytown

Smallco Ltd
Report of the Directors
For the year ended 30 June 2017

The directors present their report and financial statements of the company for the year ended 30 June 2017.

Directors of the company
The directors who have served during the year were as follows:
J Smith
B Jones

The report of the directors has been prepared taking advantage of the small companies' exemption of section 415A of the Companies Act 2006.

By order of the Board

J Smith
Director
31 January 2018

Smallco Ltd
Profit and loss account
For the year ended 30 June 2017

	Note	2017	2016
		£	£
Turnover		3,900,767	2,451,342
Cost of sales		(1,555,231)	(972,990)
Gross profit		2,345,536	1,478,352
Administrative expenses	2	(1,129,639)	(867,009)
Other operating income		20,000	10,000
Fair value gains on investment properties		10,000	10,000
Interest receivable and similar income		28	56
Interest payable and similar expenses		(19,787)	(25,989)
Profit before taxation		1,226,138	605,410
Tax on profit		(240,000)	(120,000)
Profit for the year		986,138	485,410

Smallco Ltd
Balance Sheet
As at 30 June 2017
Company registration number: 99999999

	Note	2017 £	2016 £
Fixed assets			
Tangible assets	4	489,233	492,899
		489,233	492,899
Current assets			
Stocks		312,943	153,300
Debtors due within one year	5	439,881	278,933
Cash at bank and in hand		805,253	794,041
		1,558,077	1,226,274
Creditors: amounts falling due within one year	6	(728,933)	(439,833)
Net current assets		829,144	786,441
Total assets less current liabilities		1,318,377	1,279,340
Provisions for liabilities		(156,798)	(134,966)
Net assets		1,161,579	1,144,374
Capital and reserves			
Called up share capital	7	100	100
Profit and loss account – not distributable		120,000	110,000
Profit and loss account		1,041,479	1,034,274
Shareholders' funds		1,161,579	1,144,374

These financial statements have been prepared in accordance with the provisions applicable to companies subject to the small companies' regime and the option not to file the profit and loss account has been taken under s444. The company has taken advantage of audit exemption …

The financial statements were approved and authorised for issue by the Board on 31 January 2018.

Signed on behalf of the board of directors.

B Jones
Director

Smallco Ltd
Notes to the financial statements
For the year ended 30 June 2017

1 Summary of significant accounting policies

(a) General information and basis of preparation

The company is limited by shares and incorporated in England. The address of the registered office is given in the company information on page X of these financial statements.

The financial statements are presented in sterling which is the functional currency of the company and rounded to the nearest £.

The significant accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented unless otherwise stated.

(b) Tangible fixed assets

Tangible fixed assets are stated at cost (or deemed cost) or valuation less accumulated depreciation and accumulated impairment losses. Cost includes costs directly attributable to making the asset capable of operating as intended by management.

Depreciation is provided on all tangible fixed assets, at rates calculated to write off the cost, less estimated residual value, of each asset on a systematic basis over their expected useful lives as follows:

Land	Nil
Buildings	30 years on a straight line basis
Plant and machinery etc.	25% straight line

(c) Investment properties

Investment properties for which fair value can be measured reliably without undue cost or effort are measured at fair value at each reporting date with changes in fair value recognised in profit or loss.

The methods and significant assumptions used to ascertain the fair value at the balance sheet date and fair value movement included in the profit for the year are as follows:

Properties are valued using RICS open market valuation on freehold basis, conducted annually by Smith & Co Chartered Surveyors.

Smallco Ltd
Notes to the financial statements (continued)
For the year ended 30 June 2017

(d) Stocks

Stocks are stated at the lower of cost and estimated selling price less costs to complete and sell. Cost includes all costs of purchase, costs of conversion and other costs incurred in bringing stock to its present location and condition. Cost is calculated using the first-in, first-out formula. Provision is made for damaged, obsolete and slow-moving stock where appropriate.

(e) Debtors and creditors receivable / payable within one year

Debtors and creditors with no stated interest rate and receivable or payable within one year are recorded at transaction price. Any losses arising from impairment are recognised in the profit and loss account in other administrative expenses.

(f) Loans and borrowings

Loans and borrowings are initially recognised at the transaction price including transaction costs. Subsequently, they are measured at amortised cost using the effective interest rate method, less impairment. If an arrangement constitutes a finance transaction it is measured at present value.

(g) Impairment

Assets not measured at fair value are reviewed for any indication that the asset may be impaired at each balance sheet date. If such indication exists, the recoverable amount of the asset, or the asset's cash generating unit, is estimated and compared to the carrying amount. Where the carrying amount exceeds its recoverable amount, an impairment loss is recognised in profit or loss unless the asset is carried at a revalued amount where the impairment loss is a revaluation decrease.

(h) Provisions

Provisions are recognised when the company has an obligation at the balance sheet date as a result of a past event, it is probable that an outflow of economic benefits will be required in settlement and the amount can be reliably estimated.

(i) Leases

Assets acquired under finance leases are capitalised and depreciated over the shorter of the lease term and the expected useful life of the asset. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding lease liability using the effective interest method. The related obligations, net of future finance charges, are included in creditors.

Rentals payable and receivable under operating leases are charged to the profit and loss account on a straight line basis over the period of the lease.

Smallco Ltd
Notes to the financial statements (continued)
For the year ended 30 June 2017

(j) Tax

Current tax represents the amount of tax payable or receivable in respect of the taxable profit (or loss) for the current or past reporting periods. It is measured at the amount expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax represents the future tax consequences of transactions and events recognised in the financial statements of current and previous periods. It is recognised in respect of all timing differences, with certain exceptions. Timing differences are differences between taxable profits and total comprehensive income as stated in the financial statements that arise from the inclusion of income and expense in tax assessments in periods different from those in which they are recognised in the financial statements. Unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

Deferred tax is measured using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date that are expected to apply to the reversal of timing differences. Deferred tax on revalued, non-depreciable tangible fixed assets and investment properties is measured using the rates and allowances that apply to the sale of the asset.

(k) Turnover and other income

Turnover is measured at the fair value of the consideration received or receivable net of VAT and trade discounts. The policies adopted for the recognition of turnover are as follows:

Sale of goods

Turnover from the sale of goods is recognised at the point of sale.

Rendering of services

When providing day services, turnover is usually recognised on completion of the service and, for monthly engagements, it is recognised by reference to the stage of completion at the balance sheet date.

Interest receivable

Interest income is recognised using the effective interest method.

Smallco Ltd
Notes to the financial statements (continued)
For the year ended 30 June 2017

(l) Employee benefits

When employees have rendered service to the company, short-term employee benefits to which the employees are entitled are recognised at the undiscounted amount expected to be paid in exchange for that service.

The company operates a defined contribution plan for the benefit of its employees. Contributions are expensed as they become payable.

2 Exceptional items

During the year £125,000 (2016 - £nil) of expenditure of exceptional size or incidence was recorded and related to the write-down of a trade debtor. This was included in administrative expenses.

3 Employees

The average monthly number of employees, including directors, during the year was as follows:

	2017 Number	2016 Number
Employees	18	13

Smallco Ltd
Notes to the financial statements (continued)
For the year ended 30 June 2017

4 Tangible fixed assets

	Investment properties	Land and buildings	Plant and machinery etc	Total
	£	£	£	£
Cost or valuation:				
At 1 July 2016	220,000	345,000	572,300	1,137,300
Additions	-	-	32,450	32,450
Disposals	-	-	-	-
Revaluation	10,000	-	-	10,000
At 30 June 2017	230,000	345,000	604,750	1,179,750
Depreciation:				
At 1 July 2016	-	147,001	497,400	644,401
Charge for the year	-	8,166	38,050	46,216
Eliminated on disposals	-	-	-	-
At 30 June 2017	-	155,167	535,450	690,617
Net book value:				
At 30 June 2017	230,000	189,933	69,300	489,233
At 30 June 2016	220,000	197,999	74,900	492,899

5 Debtors

	2017	2016
	£	£
Trade debtors	406,556	269,761
Other debtors	23,449	3,449
Prepayments and accrued income	9,876	5,723
	439,881	278,933

Smallco Ltd
Notes to the financial statements (continued)
For the year ended 30 June 2017

6 Creditors: amounts falling due within one year

	2017 £	2016 £
Bank loans and overdrafts	80,000	132,000
Trade creditors	244,678	49,562
Corporation tax	240,000	120,000
Other tax and social security	56,341	43,998
Finance leases	18,562	23,973
Other creditors	5,000	5,000
Accruals and deferred income	84,352	65,300
	728,933	439,833

The bank loan of £80,000 (2016 - £132,000) is secured by a floating charge over the company's assets. Finance leases are secured over the assets to which they relate.

7 Share capital

	2017 £	2016 £
Allotted, called up and fully paid	100	100

8 Financial commitments

Total financial commitments, guarantees and contingencies which are not included in the balance sheet amount to £18,000 (2016 - £22,000).

9 Post balance sheet events

After the year end the company the company's store was destroyed by flood and fire incurring uninsured stock losses of £98,000

10 Directors' advances, credits and guarantees

During the period, the company made a short-term loan to a director amounting to £20,000 for the purposes of a house purchase. Interest at the rate of 5.5% per annum is payable half-yearly and the loan is repayable on 31 December 2020.

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

FRS 105 is based on FRS 102 because the Accounting Council of the FRC wants consistency across the financial reporting framework in the UK and Republic of Ireland. It is to be noted that at the time of writing these notes there was no equivalent legislation in the Republic of Ireland for micro-entities and hence a company which might fall to be classed as a micro-entity in the Republic of Ireland cannot use FRS 105 until the legislation is enacted.

FRS 105 has significantly simplified financial reporting for micro-entities and the Accounting Council acknowledged that it would not have gone as far as the Directive has gone in making these simplifications. Many of the disclosures that have traditionally been necessary to enable a true and fair view have been removed in FRS 105 because the EU Accounting Directive does not require certain disclosures to be made. In addition certain accounting options have been removed; for example a micro-entity cannot carry investment property at fair value; it must carry the property at cost less accumulated depreciation and accumulated impairment losses. This is one of the accounting treatments which the Accounting Council does not support as it views the revaluation model as being more appropriate to investment property as such a model provides more relevant and reliable information.

Key differences: FRSSE versus FRS 105

Some of the key differences between the FRSSE (effective January 2015) and FRS 105 are outlined in the following table:

FRSSE (effective January 2015)	FRS 105
The directors have a legal obligation to ensure the financial statements give a true and fair view and hence must make appropriate disclosures where necessary.	Financial statements prepared to the minimum legal requirements are presumed to give a true and fair view. The directors do not need to consider any additional disclosures needed for the financial statements to give a true and fair view.
A Format 1 or a Format 2 profit and loss account can be prepared.	Only a Format 2 profit and loss account is permitted, structured as follows: • Turnover • Other income • Cost of raw materials and consumables • Staff costs • Depreciation and other amounts written off assets • Other charges • Tax • Profit or loss

A statement of total recognised gains and losses is needed where amounts have been taken to equity.	No statement of total recognised gains and losses is required.
The balance sheet is disaggregated e.g. tangible fixed assets are split into various components (intangible, tangible and investment property).	No disaggregation of the balance sheet is permitted hence there will only be one line item showing ‘Fixed assets’. Current assets are not split into the order of liquidity (stock, debtors, bank and cash); only one line item showing ‘Current assets’ is required.
More disclosures are needed for the financial statements to give a true and fair view.	Only disclosures in respect of advances, credit and guarantees granted to directors and financial commitments, guarantees and contingencies are disclosed at the **foot of the balance sheet**.
The FRSSE allows fair value accounting or amounts to be carried at revaluation.	No fair values or revaluation amounts are allowed under FRS 105. All previous fair values/revaluation amounts must be removed on transition and in the comparative year.
More accounting policies are allowed in the FRSSE (e.g. capitalisation of development costs and borrowing costs).	No accounting policy choices exist in FRS 105 and hence most transactions will be recognised in profit or loss rather than deferred in the balance sheet.
Company law requirements are reproduced in the FRSSE.	Not all company law requirements have been reproduced – only those which relate to the financial statements themselves have been reproduced.
Deferred tax is recognised using the timing difference approach.	Deferred tax is prohibited.
Equity-settled share-based payment transactions are disclosed in the notes.	No equity-settled share-based payment transactions are either accounted for or disclosed.

Issues to be considered where FRS 105 is concerned

The FRC are keen to emphasise that while FRS 105 is the least complex framework, accountants should consider the ‘bigger picture’ when advising a client as to which framework to apply in the preparation of their financial statements. While a micro-entity may qualify to use FRS 105, it might not necessarily be the most appropriate framework – particularly if the entity has borrowings, or is trying to obtain finance, because the disclosure requirements are significantly reduced.

Other factors to consider include:

- the eligibility criteria – for example a company whose financial statements are included in group accounts cannot apply the micro-entities regime; eligibility criteria is very restrictive;
- the scope for producing non-statutory information; for example if the client undergoes an enquiry from HMRC or the bank require more details about the financial statements;
- the pace of growth of the company; for example if the client is expected to grow at a rapid rate it might be more beneficial to choose a more comprehensive financial reporting framework; and
- the impact that the prohibition of fair values/revaluation amounts might have on the company's balance sheet and credit-rating.

Additional simplifications made in FRS 105

The micro-entities regime is intended to be deregulatory and in recognition of this, the Accounting Council have made additional simplifications as follows:

- Prohibition of the requirement for a micro-entity to account for deferred tax as the Accounting Council believes that this is a complex area of accounting and the lack of disclosures in a micro-entity's financial statements would make it impossible to distinguish between current and deferred tax.
- Prohibition of the requirement to account for equity-settled share-based payment transactions before the shares are issued. This was done because no fair values can be used under the micro-entities regime and there are no associated disclosure requirements.
- Contributions payable to a post-employment benefit plan are accounted for as an expense (this applies even if the plan is a defined benefit pension plan). However, a liability will be recognised by the micro-entity for a schedule of contributions to the extent that it relates to the deficit in the plan.
- The distinction between a micro-entity's 'functional currency' and 'presentation currency' is removed because the Accounting Council acknowledge that it is very rare for a micro-entity to have a different functional and presentational currency.
- A micro-entity can use contracted rates to translate foreign currency denominated assets and liabilities as opposed to spot rates. This will be easier for micro-entities if they enter into foreign currency transactions.
- All borrowing and development costs are to be written off as expenses in profit or loss as this is considered to be the simplest method.
- Government grants are to be accounted for using the accrual method. This is a revision from the previous Exposure Drafts which required the use of the performance method. The accrual method was a welcome change as it is considered to be the simplest method and is well-known.

- Simpler requirements for financial instruments in allocating the interest and transaction costs. There is no requirement to use the 'effective interest method' under FRS 105 as this is considered to be too onerous for a micro-entity.
- Removal of the requirement to impute a market-rate of interest where the micro-entity enters into lending arrangements at non-market rates. It was concluded that the costs of imputing market-rates of interest would outweigh the benefits.
- Simplifications for classifying financial instruments as debt or equity because micro-entities will issue simple equity instruments.
- Prohibition of the requirement to separately identify intangible assets in a trade and asset acquisition as these are not required items in the format of micro-entities' financial statements.
- No requirement to account for hyperinflation as this is unlikely to be an issue for micro-entities.
- Removal of accounting requirements for specialised activities (such as extractive industries, service concessions, heritage assets and funding commitments). This is because micro-entities will not typically enter into such transactions.

Illustrative financial statements of a micro-entity

These example financial statements have been prepared to show the requirements of company law for micro companies and FRS 105.

Micro Ltd
Profit and loss account
Year ended 31 December 2016

	2016	2015
	£	£
Turnover	300,000	285,000
Other income	10,000	5,000
Cost of raw materials and consumables	(70,000)	(50,000)
Staff costs	(20,000)	(15,000)
Depreciation and other amounts written off assets	(35,000)	(25,000)
Other charges	(110,000)	(105,000)
Tax	(15,000)	(19,000)
Profit	60,000	76,000

Micro Ltd
Balance Sheet
At 31 December 2016

	2016 £	2015 £
Fixed assets	85,000	80,000
Current assets	125,000	185,000
Creditors: amounts falling due within one year	(95,000)	(85,000)
Net assets	115,000	180,000
Capital and reserves	115,000	180,000

Directors advances, credits and guarantees
During the year the company made a loan to a director amounting to £1,000 on an interest-free basis. This loan was repaid in full on 4 February 2017.

Outstanding obligations
The company had capital commitments contracted but not provided for in the financial statements totalling £19,000 (2015: £17,000).

For the year ending 31 December 2016 the company was entitled to exemption from audit under section 477 of the Companies Act 2006 relating to small companies.
[Insert directors' responsibilities]
[Insert signature/signatories of directors signing the accounts]
[Date]

Sections 2: FRS 102 1A related party disclosures

FRS 102, SECTION 1A AND RELATED PARTIES

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* will become mandatory for small companies for accounting periods starting on or after 1 January 2016 (although early-adoption is permissible). The latest edition of FRS 102 is the September 2015 edition which caters for small entities by virtue of Section 1A *Small Entities*. Section 1A is not a 'one-stop-shop' and only outlines the presentation and disclosure requirements that a small entity, or a micro-entity choosing not to apply FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*, is required to follow. In respect of recognition and measurement of amounts, these are based on full FRS 102.

The issue of related parties has often posed problems for accountants (and, indeed, auditors) largely because of their subjective nature and the Accounting Directive has effectively reduced the disclosure requirements which a small company is legally required to make in the financial statements.

Related party disclosures under FRS 102, Section 1A

Related party disclosures are outlined in paragraphs 1AC.34 to 1AC.36 of Section 1A in FRS 102. The disclosures are split into three categories:

- entities which are subsidiaries;
- transactions entered into with related parties; and
- directors' transactions.

Entities which are subsidiaries

When a small entity is a subsidiary, the following information is required to be given in respect of the parent of the smallest group for which consolidated financial statements are drawn up of which the small company is a member:

a) the name of the parent which draws up the consolidated financial statements;
b) the address of the parent's registered office (whether in or outside the UK); or
c) if it is unincorporated, the address of its principal place of business.

Transactions entered into with related parties

This is (potentially) where the problems may arise for small companies due to the subjectivity involved in deciding whether, or not, related party transactions need disclosure. Paragraph 1AC.35 says that particulars must be given of material transactions which the small entity has entered into *'… that have not been concluded under normal market conditions.'* The phrase in italics can be taken to mean that the related party transactions have not been undertaken on an arm's length basis, however FRS 102 does not use that terminology but it is taken to mean the same thing. There are three types of parties with whom related party transactions are disclosable:

a) owners holding a participating interest in the small entity;
b) companies in which the small entity itself has a participating interest; and
c) the small entity's directors (or members of its governing body).

The particulars which must be given in respect of related party transactions not concluded under normal market conditions include:
a) the amount of such transactions;
b) the nature of the related party relationships; and
c) other information about the transactions necessary for an understanding of the financial position of the entity.

The problem which many practitioners may face is interpreting what 'normal market conditions' are because the term is not defined in any of the standards.

Example – Normal market conditions
Company A Ltd trades with Company B Ltd. Company B Ltd (B) is owned and controlled by the wife of the director and majority shareholder of Company A Ltd (A) and hence under full FRS 102 would be a related party.

All transactions entered into between A and B are undertaken on normal commercial terms and no favourable rates or discounts are given.

Under Section 1A, this is not a related party transaction because close family members are not considered (although they would be under full FRS 102 due to the definition of a related party in the Glossary). In this scenario it can be said that all transactions between A and B are conducted under normal market conditions because no favourable rates or discounts are given, so even if Company B was deemed a related party because, for example, Company A had a participating interest in B, no disclosure would be needed. Had favourable rates or discounts been given to B (i.e. rates or discounts which would not be granted to non-related parties) then these transactions would require disclosure in the financial statements of both companies if the value of the transactions were material.

Example – Transaction not concluded under normal market conditions
Company C Ltd has four investment properties on its balance sheet which it values at fair value through profit or loss in accordance with Section 16 *Investment Property* in FRS 102. On 4 September 2016, an investment property with a market value of £350,000 was sold to the managing director, who holds a 52% share in the business, for £125,000.

In this example it cannot be said that this transaction has been undertaken under normal market conditions because the director has acquired an investment property from a company in which he is the majority shareholder at a significant discount. It is highly unlikely that the company would sell such a property to an unconnected third party for such a discount and hence this transaction would require to be disclosed in the entity's financial statements.

In some cases, 'normal market conditions' can be fairly easy to decipher and hence it follows that any transactions involving such market conditions can be straightforward to establish whether, or not, they require disclosure.

One of the emerging issues that is beginning to be questioned is the issue surrounding directors' remuneration in a small company. In practice it is not uncommon to organise directors' remuneration and dividends in a tax-efficient manner; for example, small company directors are often paid a salary up the pay as you earn threshold with any additional remuneration taken in the form of dividends. Initially, many practitioners may be asking the question 'why all the fuss?' The issue is due to the fact that directors' remuneration is no longer a legally required disclosure in the financial statements following the transposition of the EU Accounting Directive.

Directors' remuneration would require disclosure under paragraph 1AC.35 when it is concluded that such remuneration has not been undertaken under normal market conditions. Views differ on what 'normal market conditions' in this context mean. The upshot of the removal of the requirement in law to disclose directors' remuneration and only to disclose it as a related party transaction if such remuneration has not been concluded under normal market conditions essentially means that judgement will need to be exercised, both on the part of the small company directors and of the practitioner. Reliance on accounts production software systems should not be a reason for deliberately leaving out the disclosure as most systems will have functionality allowing directors' remuneration to be disclosed.

Where uncertainties are present, particularly surrounding the issue of directors' remuneration and disclosure *versus* non-disclosure, the advice is to document any decisions or conclusions reached. Practitioners are **strongly advised** to make a professional judgement call on whether the directors' remuneration issue is concluded under normal market conditions (some commentators argue that 'normal market conditions' is not 'market rate' whereas others bring in 'market rate' as a test to see if the transaction is under 'normal market conditions'). Documenting decisions reached on this, or any other issue that requires professional judgement, will be invaluable in case any of the judgements are questioned further down the line.

Paragraph 1AC.35 does try to steer the practitioner into making the disclosures by saying that the small entities choosing to disclose all transactions with related parties (including those concluded under normal market conditions) would be compliant with the law. However, the advice is to proceed with caution and document any decisions reached.

Directors' transactions

Directors' transactions include directors' remuneration and dividends paid to directors (see above section). However, any advances and credits granted by the small entity to the director(s) and guarantees of any kind entered into by the small company on behalf of its directors must be shown in the financial statements.

Advances and credits

The details required of an advance or credit are:

a) its amount;

b) an indication of the interest rate;
c) its main conditions;
d) any amounts repaid;
e) any amounts written off; and
f) any amounts waived.

Monetary totals must be stated in respect of items a), d), e) and f).

Guarantees

The details required for a guarantee are:

a) its main terms;
b) the amount of the maximum liability that may be incurred by the small entity; and
c) any amount paid and any liability incurred by the small entity for the purpose of fulfilling the guarantee (including any loss incurred by reason of enforcement of the guarantee).

Monetary totals must be stated in respect of items b) and c).