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### IFRS for SMEs

The International Accounting Standards Board (“IASB”) has issued an International Financial Reporting Standard (“IFRS”) designed for use as a stand-alone document by small and medium-sized entities (“SME”) in place of the full IFRSs.

A SME is defined as an entity that:

- does not have public accountability (i.e. its debt or equity are not traded or about to be traded in a public market (including AIM and Plus Markets)); or
- holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (including banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks, but excluding entities that hold “clients monies” such as travel agents, estate agents or entities that receive payment in advance).

As well as issuing the standard, the IASB have issued a:

- Basis for Conclusions Document providing additional guidance on why certain simplifications were made and
- Illustrative Financial Statements and Presentation and Disclosure Checklist.

Many of the principles in the full IFRSs for recognising and measuring assets and liabilities have been simplified, (such as the removal of available for sale, held to maturity and fair value options for financial instruments; removal of the revaluation model for fixed assets; proportionate consolidation for joint ventures; allowing the measurement of investment property to be driven by circumstances; and the removal of various options for government grants), topics not relevant to SME’s (such as earnings per share, interim financial reporting, segment reporting and special accounting for assets held for sale) have been omitted and the number of required disclosures has been significantly reduced. Also, to reduce the reporting burden for SMEs, revisions to the IFRS will be limited to once every three years.

The main simplifications to the recognition and measurement principles in full IFRS’s include:

- **Financial instruments:**
  - Financial instruments meeting specified criteria are measured at cost or amortised cost. All others are measured at fair value through profit or loss. This avoids the inherent complexities of classifying financial instruments into four categories, such as assessing management’s intentions and dealing with ‘tainting provisions’.
  - The IFRS for SMEs establishes a simple principle for derecognition. The ‘pass-through’ and ‘continuing involvement’ tests in full IFRSs are dropped.
  - Hedge accounting requirements, including the detailed calculations, are simplified and tailored for SMEs.
- **Goodwill and other indefinite-life intangible assets** – always amortised over their estimated useful lives (ten years if useful life cannot be estimated reliably).
- **Investments in associates and joint ventures** – can be measured at cost unless there is a published price quotation (when fair value must be used).

- **Research and development costs** – must be recognised as expenses.
- **Borrowing costs** – must be recognised as expenses.
- **Property, plant and equipment and intangible assets** – residual value, useful life and depreciation method for items of property, plant and equipment, and amortisation period/method for intangible assets, need to be reviewed only if there is an indication they may have changed since the most recent annual reporting date (full IFRSs require an annual review).
- **Defined benefit plans:**
  - All past service cost must be recognised immediately in profit or loss.
  - All actuarial gains and losses must be recognised immediately either in profit or loss or other comprehensive income.
  - An entity is required to use the projected unit credit method to measure its defined benefit obligation and the related expense only if it is possible to do so without undue cost or effort.
- **Income tax** – requirements follow the approach set out in the IASB's ED *Income Tax*, published in March 2009, which proposes a simplified replacement for IAS 12 *Income Taxes*.
- **No separate held-for-sale classification** – instead, holding an asset (or group of assets) for sale is an impairment indicator.
- **Biological assets** – the fair value through profit or loss model is required for biological assets only when fair value is readily determinable without undue cost or effort. Otherwise, SMEs follow the cost-depreciation-impairment model.
- **Equity-settled share-based payment** – the directors' best estimate of the fair value of the equity-settled share-based payment is used to measure the expense if observable market prices are not available.

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#### **UITF 40: Treatment of Contingency Fee Payments.**

Despite the publication of Accounting Standards Board's ("ASB") Urgent Issues Task Force Abstract 40 ("UITF40"), there was uncertainty about the treatment of contingent contracts and the recognition of income where a contingent event occurred between the balance sheet date and the signing of the accounts, with two distinct views about the correct treatment within the accountancy profession.

The first view was that UITF40 made it clear that, if completion of the contract was contingent on a specific event, the performance of which was outside the seller's control, no income or profits should be recognised until that event had occurred. As the key date for assessing contract performance was the balance sheet date, post-balance sheet events should be ignored.

The second view was that, if the contingent event occurred between the balance sheet date and the date of signing, it was possible that the asset could have a value and this should be reflected in accordance with Financial Reporting Standard ("FRS") 21 "Events after the balance sheet date".

In July 2008, the ASB published a statement clarifying the treatment of contingent fee arrangements which straddled the balance sheet date. The statement confirmed that the resolution of a contingent event in the post-balance sheet period is a condition that arises after the balance sheet date and should be treated as a non-adjusting event under FRS 21. As a result, the position taken at the balance sheet date should not be amended following the post-balance sheet resolution of the event, although disclosure of the event may be required.

However, the ASB did not provide guidance on the acceptability of the two possible approaches to accounting for the cost of work performed under contingent fee contracts, namely:

- expensing the cost as incurred; or
- recognising the costs as work in progress at the balance sheet date.

In a letter to the ICAEW dated 5 May 2009, the ASB agreed that either approach is permissible under UK Generally Accepted Accounting Principles (“GAAP”). Therefore, either approach should be acceptable to HM Revenue & Customs (“HMRC”). When preparing financial statements, the preparer should apply their professional judgement to select the accounting policies most appropriate to their particular circumstances in accordance with FRS 18 “Accounting Policies”.

HMRC have launched many enquiries into the tax returns of professional service firms for accounting periods ending after 22 June 2005. These enquiries have generally focused on the methodology applied in respect of UITF40 and the amount of the adjustment that has been spread.

The diversity of positions taken, which reflected the level of uncertainty within the accounting profession, has led HMRC to challenge the treatment adopted in respect of contingent contracts. By Autumn 2008, many enquiries were underway but making little progress because of the continuing uncertainty. While HMRC has no role in the establishment of GAAP, many of those enquiries were suspended while the matter was referred to the ASB for a second time. Following the publication of the ASB letter, it appears that HMRC have instructed offices to conclude enquiries in line with the acceptable diversity of positions outlined in that letter.

However, this does not seem to be the end of the matter for more changes are in the pipeline. The IASB has published a discussion document “Preliminary views on revenue recognition in contracts with customers” with the stated aim of developing a single model for revenue recognition across all industries. It proposes that revenue from services should be recognised when the customer receives the service. This means, for example, that revenue from performing an audit will not be recognised until the audit report is issued and fees for a conveyance will not be recognised until the transaction has completed.

Currently, under UK GAAP, in both cases, revenue would be recognised based on the activity performed at the reporting date, even if the customer will not receive the benefit of the service for some time. The new rules might sound like a return to pre-UITF40 days, but the logic behind them is actually very different.

Depending on how IFRS evolve, that suggests a possibility that the accounts and tax computations of professional service firms may be subject to further upheaval.

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### **Companies Act 2006: Accounts and Audit Changes**

The Companies Act 2006 (Accounts, Reports and Audit) Regulations 2009 will make certain changes to the accounts and audit provisions of the Companies Act 2006 (“the Act”) and related Regulations.

The main changes relate to the incorporation of additional provisions on the preparation, approval and audit of any separate corporate governance statement that is prepared by a listed company under the Disclosure and Transparency Rules of the Financial Services Authority.

However, the opportunity has been taken to make some minor amendments to other aspects of the legislation. The main ones are:

- an amendment to section 444 A(4) of the Act (which deals with the filing obligations of companies that qualify for the small companies exemption in respect of directors’ report) to remove the requirement for the copy of the auditors report delivered to the Registrar of Companies to include a manuscript signature. This change will come into effect on 1 October 2009;

- minor amendments to SI 2008/409 and SI 2008/410 dealing with the disclosure requirements for Small, and Medium and Large-sized companies and groups respectively. Regulation 12 in each set of regulations will refer additionally to section 841(2)(a) of the Act which deals with provisions to be treated as realised losses for the purposes of determining distributable profits. A new paragraph on realised losses will be inserted into Schedule 7 to SI 2008/409 for small companies and groups and Schedule 9 to SI 2008/410 for Medium and Large companies and groups dealing with the interpretation of the term “provisions”. These changes will apply to accounting periods beginning on or after 6 April 2008 that have not ended before the date on which the new Regulations come into force.

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### **Signing Audit Reports**

For accounting periods beginning on or after 6 April 2008, under Section 503 of the Companies Act 2006 (the “Act”), the audit report must state the name of the auditor and be signed and dated by the “senior statutory auditor” in his/her own name for and on behalf of the audit firm. Another partner or responsible individual is not able to sign for and on behalf of the senior statutory auditor. This differs significantly from the Companies Act 1985 which permitted the audit report to be signed in the name of the firm by a person authorised to sign on the firm’s behalf.

It is important to note that there is no requirement for the senior statutory auditor to sign the auditor’s report that is delivered to Companies House. This copy of the audit report can be signed in the name of the firm by a person authorised to sign on its behalf, but must have the name of the senior statutory auditor as it appears on the register (i.e. “Andrew Smith for and on behalf of ABC LLP” typed in, but they can be signed as “ABC LLP”). However the original copy for the client must be signed by the Senior Statutory Auditor before the authenticated copy is sent to Companies House. Note that from 1 October 2009 no manuscript signature of the auditors will be required on the authenticated copy sent to Companies House.

The APB issued guidance on what happens if the Senior Statutory Auditor is indisposed in Bulletin 2008/06 “The Senior Statutory Auditor” under the UK Companies Act 2006”.

Firms need to put appropriate contingency plans in place where it is likely that the Senior Statutory Auditor will be unable to sign the auditors report. Such plans need to take account of the following

- Where there is an Engagement Quality Control Reviewer (“EQCR”):
  - both the audit engagement partner and EQCR roles must be performed properly
  - the audit engagement partner must review what s/he needs to review under auditing standards.
  - the EQCR must provide challenges as required by International Standard on Auditing (UK & Ireland) (“ISA”) 220 “Quality Control for Audits of Historical Financial Information”.
  - If the engagement partner is unavailable, the EQCR is normally best placed to carry out the engagement partner level of review as s/he has already carried out reviews of significant judgements and key working papers, and this would be the most efficient option.
  - If the EQCR has not completed his or her work in that role, they will be reviewing their own work, and therefore a new EQCR would be required.
  - However, by signing the auditor’s report, the EQCR would be unable to act as independent reviewer in the future as his/her objectivity may have been impaired by assuming the Senior Statutory Auditor role.
- Where there is no EQCR
  - if the Senior Statutory Auditor is ill, it may be better to wait until s/he is better or use the option of electronic signature, or

- if the Senior Statutory Auditor is unable to continue as an engagement partner, a new one should be appointed. This new one will need to review the audit work performed to the date of change and cannot just rely on the work of their predecessor. The new engagement partner does not need to re-perform everything their predecessor carried out, but their review needs to be sufficient to enable them to satisfy themselves that the work to date has been planned, carried out and reviewed in accordance with auditing standards, regulatory and legal requirements. This could be carried out by having a discussion with the audit team on various aspects of the audit as appropriate.

The Senior Statutory Auditor can use his or her usual signature of the auditor's report for the client, but the printed name must be as it appears on the register. There is no need to include designatory letters, but it will probably be usual to do so. Therefore, if the name on the register was Andrew James Smith, this must be printed on the signature block, but the signature could be Andrew Smith, A J Smith, Bill Smith etc.

Therefore a typical signature block might look like:

<< *Usual signature* >>

Andrew James Smith FCA

Senior Statutory Auditor

For and on behalf of << *Audit Firm Name* >>

Statutory Auditor

Chartered Accountants

<< *Address* >>

<< *Date* >>

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### **Limited Liability Partnerships ("LLPs") – Changes to Regulations**

The Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 have been issued and come into force on 1 October 2009, except for certain regulation making powers. These Regulations replace provisions of the Limited Liability Partnerships Regulations 2001 which apply the provisions of the Companies Act 1985 to LLPs and apply the provisions of the Companies Act 2006 (the "Act").

Provisions on accounts and audit contained in the Companies Act 2006 have already been applied to LLPs by earlier statutory instruments and these apply for accounting periods beginning on or after 1 October 2008. These Regulations complete the application of the Act to LLPs.

The Regulations apply the following provisions of the Act to LLPs (with appropriate modifications to take account of the particular characteristics of LLPs):

- the formalities of doing business
- names and trading disclosures
- registered offices
- the register of directors and protection from disclosure of residential addresses
- debentures (including their certification and transfer)
- annual returns
- the registration of charges
- arrangements and reconstructions (including application of the Companies (Cross-Border Mergers) Regulations 2007)
- fraudulent trading
- protection of members against unfair prejudice
- dissolution and restoration to the register
- trading disclosures of overseas companies
- the registrar of companies

The Regulations make some substantive changes to the law relating to LLPs from 1 October 2009 including:

- The need to keep a register of its members containing certain particulars, including a service address for each individual member and stating whether a member is a designated member. The LLP must give notice to the Registrar of Companies of the place at which the register is kept available for inspection and any changes in that place (unless it is kept at all times at the LLP's registered office). It must also be open for inspection by any member of the LLP without charge and by any other person for a fee.
- The need to keep a register of each member's usual residential address; this applies unless a confidentiality order was in force prior to that date. The new provisions on protection from disclosure of addresses in sections 240 to 246 of the Act are also applied to LLPs.
- The Act provisions on dissolution and restoration to the register to enable a sole remaining member to strike off an LLP. If an LLP carries on business without at least two members for more than 6 months, the remaining member is liable (jointly and severally with the LLP) for the debts contracted during the period. However, under the current law, an LLP with fewer than two members is not able to apply for voluntary strike-off of the LLP. The section on voluntary striking off has therefore been applied to LLPs, modified to enable a sole remaining member to dissolve the LLP.
- The legislation applies to small businesses which incorporate as limited liability partnerships. To minimise the impact of the requirements on small LLPs employing up to 20 people, and in line with the better regulation and 'think small first' objectives of the Act, the Regulations recast the law in a more coherent and accessible form, benefiting LLPs and their intermediaries. By applying the Act, LLPs of all sizes will be able to take advantage of some of the benefits enjoyed by companies.

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### **Charity Reporting**

There has been some confusion over charity reporting for accounting periods beginning on or after 1 April 2008 (NB Not 6 April 2008).

For these accounting periods, the requirements are the same for charitable trusts and small charitable companies and are:

<b>Type of Report</b>	<b>Criteria</b>
Audit	Gross income > £500k in current year; or Gross assets > £2.8m and Gross income > £100k in current year
Independent Examination	Gross income > £10k but < £500k  Qualified independent examiner if gross Income > £250k
Total Exemption	Gross income < £10k

Points to note are:

- All companies with assets > £2.8m will require an audit, but a trust with assets > £2.8m but income <£100k will fall under the independent examination regime.
- The audit report will change as a company drops in/out of the small company regime, which could be problematic. For charitable companies where this could happen, it may be easier for the members/trustees to deposit a notice requiring an audit under the Companies Act each year.
- For small charitable companies requiring an independent examination, the report will be under the Charities Act and not under the Companies Act

- For periods beginning on or after 1 April 2008, charitable companies with income between £10k and £90k will require independent examination. Under the previous regime they were totally exempt from any reporting requirement.

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### **FRS 30 “Heritage Assets”**

The Accounting Standards Board (“ASB”) has issued a new Financial Reporting Standard (“FRS”) that will improve the reporting of assets held by museums and art galleries (including charities). FRS 30 “Heritage Assets” introduces significant new disclosure requirements for reporting the content and value of collections. FRS 30 should be applied in respect of accounting periods beginning on or after 1 April 2010 and earlier application is encouraged.

FRS 30 applies to all heritage assets that are held and maintained by an entity principally for their contribution to knowledge and culture. Heritage assets can have historical, artistic, scientific, geophysical or environmental qualities.

Assets that are used by an entity in its operations should be accounted for as operational assets in accordance with FRS 15 ‘Tangible fixed assets’, notwithstanding historical or other heritage qualities.

FRS 30 sets out new disclosure requirements for the reporting of heritage assets, which apply whether or not they are reported in the balance sheet. Where heritage assets fall within the scope of FRS 30, the disclosure requirements of FRS 15 do not apply.

FRS 30 retains the recognition and measurement requirements in FRS 15 which require heritage assets to be reported as tangible fixed assets in the balance sheet where information is available on cost or valuation. There are, however, some relaxations to the measurement requirements of FRS 15 to encourage the reporting of heritage assets in the balance sheet at valuation.

The main features of FRS 30 are:

- The disclosures should apply to all entities that hold heritage assets, regardless of whether these assets are reported in the balance sheet. These disclosures will provide information about an entity’s total holding of heritage assets and the entity’s stewardship of these assets.
- The disclosures should make clear the accounting policies adopted for an entity’s holding of heritage assets and the extent to which these assets are recognised in the balance sheet. The disclosures should provide readers with an understanding of the asset values being reported as well as the entity’s policies for managing its total holding of heritage assets.
- The accounting in respect of the recognition and measurement of heritage assets should follow the requirements of FRS 15, as supplemented by the requirements of this standard.
- To encourage a valuation approach, the FRS allows entities to use internal valuations without the need for a full valuation every five years.

Illustrative examples of disclosures are set out in Appendix II to the FRS.

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### **Solicitors Accounts Rules 1998 Changes**

The Solicitors Regulation Authority (“SRA”) has issued amendments to the Solicitors’ Accounts Rules 1998 (“SAR”) that are effective from 31 March 2009. The changes reflect the introduction of Legal Disciplinary Practices and firm based regulation. However, there are two important changes that will affect all SAR assignments:

- **The new Accountant's Report Form.**

The SRA have issued a new Accountants Report Form ("ARF") that coincides with the implementation of amendments to the SAR.

This new style report should be used by Accountants when submitting an ARF with a reporting date (the financial year end for the law firm) that is on or after 31 March 2009. An old style ARF will be acceptable for periods that end before 31 March 2009 and the SRA have also indicated that for a short period of time they will accept the incorrect style of ARF. But clearly it would be better to submit the correct form!

The SRA will not necessarily send the accountant a new style ARF for each relevant client. It is the Accountant's responsibility to ensure their report is submitted in the correct format. An electronic copy of the new ARF is available from the SRA website at:

[www.sra.org.uk/documents/rules/sar/solicitors-accounts-rules-appendix-5.pdf](http://www.sra.org.uk/documents/rules/sar/solicitors-accounts-rules-appendix-5.pdf)

There is a significant change to the sections that disclose the names of partners in the firm. In the case of Recognised Bodies (partnership, LLP or Company recognised by the SRA under Section 9 of the Administration of Justice Act 1985) the new ARF the requirement is that at section 3B, only the managers that are serving at the date of ARF is signed (i.e. not at the year-end) by the reporting accountant should be disclosed. It is therefore possible for a manager to join and leave a firm and never be included on an ARF.

In contrast for Sole Practitioners there is a requirement to list the name of the Sole Practitioner and any consultant or employee who held or received client money, or operated a client's own account as signatory during the report period.

- **Revised engagement terms**

A new section 34(9) in the Solicitors Act 1974 imposes a mandatory whistle blowing duty on a solicitor's reporting accountant. The new statutory duty is reflected in the amended rule 38 of the SAR 1998 which requires the reporting accountant's rights and duties to be set out in a letter of engagement.

The statutory duty takes effect on 31 March 2009, so the letter of engagement for any accountant's report signed on or after 31 March 2009 will need to include the new rule 38 terms.

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### **Problematic Punctuation in Contracts**

A recent House of Lords case, *Chartbrook Ltd v Persimmon Homes Ltd and others*, re-iterated the need for care in drafting contracts and the need for precise punctuation.

In this case, the contract contained an additional payment to be calculated in accordance with a specified formula. The formula contained a "grammatical ambiguity" with the result that each party put forward a different interpretation of the calculation with wildly different results – one amount being nearly 5 times greater than the other.

The House of Lords held that agreements are generally taken as having the meaning that would be understood by a reasonable person, having available to him the background knowledge reasonably available to the original parties. Only in very exceptional circumstances, or during a claim for rectification, will pre-contractual negotiations be relevant.

A pragmatic solution to drafting a contract where there is a complex formula is to include a numerical example illustrating the application of the formula.

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