



CHARTERED CERTIFIED ACCOUNTANTS

Article topic: Financial Reporting

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Disclosure Problems Revisited

A couple of my past articles have been on the subject of the burdensome reporting requirements which are now required. Unfortunately the profession is becoming increasingly pedantic in relation to disclosure requirements and this issue can cause a considerable amount of misunderstanding, particularly for sole practitioners trying to find a balance between making a living and complying with our increasingly bureaucratic profession.

This article looks at some of the main disclosures in a set of SME financial statements in an attempt to illustrate how the disclosures should be made within a set of SME financial statements which may alleviate some of the misunderstanding practitioners often encounter. It is particularly relevant to those sole practitioners who do not have accounts production software and for those that do, care must be taken to make sure the disclosures are both relevant and accord to the practices adopted by your client.

Throughout this article, the disclosures concerned will be in accordance with FRSSE (effective April 2008) which is applicable for accounting periods commencing on or after April 2008. Accounting periods commencing before this date should use FRSSE (effective January 2007).

Basis of accounting

The basis of accounting note informs the user how the accounts have been prepared and which reporting framework has been used in their preparation. The basis of accounting is usually found at the start of the notes to the financial statements and a typical disclosure would say:

The financial statements have been prepared under the historical cost convention, modified to include the revaluation of certain fixed assets [note only include the revaluation aspect if you have a client who has assets stated at valuation] and in accordance with the Financial Reporting Standard for Smaller Entities (effective April 2008).

Turnover

Turnover is often the highest figure stated in a set of financial statements and in practically all cases will be a material figure. Financial statements must contain a description of the accounting policies that are material (i.e. judged to be critical) to the financial statements and turnover will undoubtedly be a material policy. Preparers of financial statements often place too much reliance on 'boiler-plate' policies generated by their accounts production software. In addition, software generated policies tend to only disclose the basics – users must tailor the policies to their client. A typical turnover note would read:

Turnover comprises the invoiced cost of goods sold during the year, excluding value added tax, and net of trade discounts. The company's policy is to recognise a sale when substantively all the risks and rewards in connection with the goods have been passed to the buyer. In respect of long-term contracts and contracts for on-going services, turnover is recognised by reference to the stage of completion and when a right to consideration exists. [Note – the last sentence may not be applicable to every client.]

Tangible fixed assets

In many cases, accounts production software will simply detail a list of depreciation rates applicable to a client. In addition, fixed assets may often be a material figure and therefore preparer's must appreciate that this is a **fixed asset** accounting policy, not just a depreciation policy. A typical disclosure would read:

Fixed Assets

All fixed assets are initially recorded at cost.

Depreciation

Depreciation is computed to write off the cost of an asset, less its estimated residual value, over the useful economic life of the asset as follows:

<i>Computer equipment</i>	-	<i>33% straight line</i>
<i>Fixtures and fittings</i>	-	<i>25% reducing balance</i>
<i>Plant and machinery</i>	-	<i>20% straight line</i>

Investment Properties

Some clients in the SME sector hold properties for their investment potential – particularly those that rent them out to third parties. Again, investment properties can (and often are) a material item in the financial statements and thus a policy in relation to accounting for them will be required. Investment properties, accounted for in accordance with paragraph 6.50, which states that such properties will not be subject to depreciation, depart from the Companies Act 2006 requirements in that the Companies Act 2006 requires all properties be depreciated. A typical disclosure would read as follows:

No depreciation is provided for in respect of investment properties in accordance with the Financial Reporting Standard for Smaller Entities (effective April 2008). Such properties are held for their investment potential and not for consumption within the business. This is a departure from the Companies Act 2006 which requires all properties to be depreciated and the directors consider that to depreciate them would not enable the financial statements to give a true and fair view. Investment properties are stated at their market value at the balance sheet date.

Stocks

Again, lots of accounts production software programmes generate the standard SSAP 9 'lower of cost or net realisable value' note which is often not enough because stocks are also likely to be a material amount in the financial statements. This policy therefore should be client-specific rather than 'boiler plate'. An example of a typical disclosure is:

Stocks are valued at the lower of cost or net realisable value after making due allowance for obsolete and slow-moving items. Cost is calculated using the first-in first-out basis of valuation. [Note – companies adopting IFRS as their framework cannot value stock using the last-in first-out method].

Preparer's of financial statements often forget to include how 'cost' is determined.

Finance and operating leases

Practitioners who do not rely on accounts production software often fail to disclose this policy despite assets subject to finance or operating leases being material to the financial statements. SSAP 21 and FRSSE require finance leases to be capitalised whilst operating lease payments are simply charged to the profit and loss. A typical disclosure note would read:

Hire purchase and leasing

Assets obtained under hire purchase contracts and finance leases are capitalised as tangible fixed assets. Assets acquired under finance leases are depreciated over the shorter of the lease term and their useful lives. Assets acquired under hire purchase contracts are depreciated over their useful lives. Finance leases are those where substantially all of the benefits and risks of ownership are assumed by the company. Obligations under such agreements are included in creditors, net of the finance charge allocated to future periods. The finance element of the rental payment is charged to the profit and loss account so as to produce a constant periodic rate of charge on the net obligation outstanding in each period.

Rentals applicable to operating leases where substantially all of the benefits of risks of ownership remain with the lessor are charged to the profit and loss account as incurred.

Deferred tax

Deferred tax is often not material to clients in the SME sector, but could well be given the HMRC's Annual Investment Allowance. Where deferred tax is material to the financial statements then a typical disclosure (assuming no discounting of deferred tax balances) would be:

Deferred taxation

The charge for deferred tax takes into account taxation deferred as a result of timing differences between the treatment of certain items for taxation and accounting purposes. In general, deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date. Deferred tax assets are recognised only to the extent that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits. Deferred taxation is measured on a non-discounted basis at the tax rates that would apply when the timing differences reverse based on tax rates and laws that have been enacted, or substantively enacted, by the balance sheet date.

Turnover (non-accounting policy)

In addition to the turnover accounting policy, clients are required to disclose in their financial statements the percentage of their sales between UK and overseas. A typical disclosure is:

During the year to 31 December 2008, 20% of the company's turnover was derived from markets outside the United Kingdom (2007: 23%).

Other frequently forgotten disclosures

Tax and revalued assets

It is common in the SME sector for clients to adopt the revaluation model (often referred to as the 'alternative accounting rules' for establish the carrying amount for their land and buildings. Where clients adopt this policy then they are required to disclose the amount of tax payable or recoverable if the assets were sold at the values shown. A typical disclosure would be:

If the building was sold at the carrying amount in the balance sheet the amount of tax payable would be £X (20X8: £X)

Government grants

Where a client has received government grants or assistance, their financial statements should disclose the effects of the grants on the results of the period or the financial position.

Directors' retirement benefits

Where the company contributes into a pension scheme where the director(s) is accruing benefits, then the number of director(s) who are accruing the benefit should be disclosed:

During the year retirement benefits were accruing to 3 directors (2008: 4) in respect of money purchase pension schemes.

This article has considered some of the main disclosures in a SME client using FRSSE and offered examples that may help preparers of financial statements, particularly those practitioners not using accounts production software.

Some clients will often require more disclosures than others and with professional bodies becoming increasingly particular about correct disclosures and following protocol; it is often beneficial to invest in reputable accounts disclosure checklists.

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