

BY ALL ACCOUNTS NEW UK GAAP

"FRS 102 SENDS OUT A MESSAGE THAT CHARITY ACCOUNTING IS FIRMLY ON THE AGENDA" P22

Proceeding with caution

Navigating the challenges of the reporting structure

The end of the journey

Roger Marshall on how we arrived at the new GAAP

Standard bearers

What the FRC has in its sights in future



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Checking out the new UK GAAP



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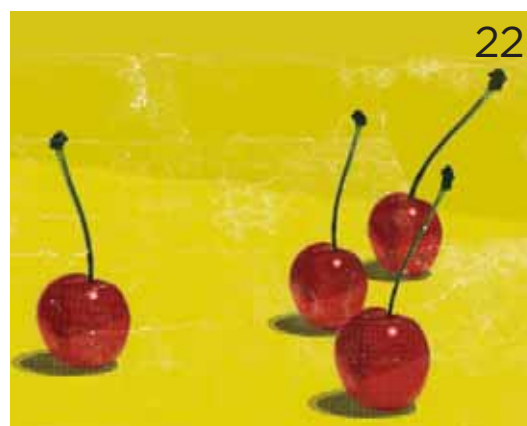
‡Benefit In Kind rate for the 2013/2014 tax year on the Volvo V40 D2 ES Manual for a 20% taxpayer.

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Journey's end?



**FINANCIAL
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Cast your mind back to 2002. A year after Tony Blair's second successive landslide election victory



some of the lustre was starting to come off the New Labour government as the prime minister sought to persuade reluctant allies that a war in Iraq was justified. David Cameron was merely the newly-elected Conservative MP for the Oxfordshire constituency of Witney. Talk of an EU referendum centred on whether the UK should join the eurozone rather than whether the UK should leave the union altogether. The newspapers reported on accounting scandals that shattered investors' confidence and made corporations such as Enron and WorldCom household names around the world.

It was also in 2002 that the now-defunct Department for Trade and Industry published a consultation document on the possible extension of the European Regulation on International Accounting Standards that proposed extending the use of IFRS beyond those listed companies that would be required to use them from 2005 under EU law. So began the long and sometimes arduous journey that - via one or two dead-ends and not a few changes of direction - has finally resulted in the publication of the three new standards at the core of a brand new UK GAAP.

Along the way we have seen a plethora of discussion papers and exposure drafts. Ideas have come and gone as the standard-setters have consulted extensively and listened carefully to their constituents. Do you remember discussions about the phased approach to convergence with IFRS, the original three-tier model that would have extended the use of IFRS to all publicly accountable reporting entities, the ill-fated FRSME, and the proposed separate standard for public benefit entities? All of these concepts moved the project forwards, but ultimately withered on the vine. Now we've finally reached the beginning of the end of the magical mystery tour of options for accounting outside the listed sector.

At the heart of the new regime is FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. There are inevitably many references to this standard in this publication. The majority of large and medium-sized UK entities will apply FRS 102 when preparing their annual financial statements. Weighing in at only 225 pages (plus appendices), it is a relatively slim volume that is said to be about 10% of the length of the collection of SSAPs, FRSs and UITF abstracts that make up current UK GAAP. What's more, it is written in relatively accessible and clear language and is generally easier to read than current UK GAAP, not least as a result of its generally simplified language and structure.

The proof of the pudding will of course be in the eating, and early application is already throwing up some concerns, but hopefully in a few years' time there will be wide agreement that the standard-setters more or less got it right. No doubt, in the short-term, the move to the new regime will not be without its costs and practical challenges. The faculty is working hard to provide help for its members every step of the way.

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Faculty news

A WEALTH OF RESOURCES

Don't forget that as a faculty member you have access to a wealth of resources, including an ever-expanding range of factsheets on the new UK GAAP, specifically designed to help you cope with the transition to the new regime. We have already published factsheets called *The New UK Regime, Reduced Disclosure Framework* and *The New Financial Reporting Standard*. Download them today from icaew.com/frffactsheets

Further factsheets on more advanced topics such as financial instruments will be added in due course.

As a faculty member, you can also join our regular webinars on UK GAAP and other topical issues free of charge. What's more, recordings of all our previous webinars are available at icaew.com/frfwebinars exclusively for faculty members, so if you weren't able to attend on the day – or if you'd just like to listen again – you can catch up whenever you like.



HAVE YOU VISITED OUR WEBSITE LATELY?

In recent months we have developed a new, distinctive section of our website that focuses specifically on the new UK GAAP regime. Here you can access factsheets, webinar recordings, articles and other resources such as checklists and model accounts. Visit icaew.com/newukgaap to see what you have been missing.

Also, don't forget to look out for your monthly e-bulletin for all the latest news and resources.

SIGN UP NOW FOR OUR UK GAAP ROADSHOWS AND CONFERENCE

This year's autumn roadshow series on the theme of 'preparing to move to the new UK GAAP' is now under way. We'll be taking a detailed look at the new regime, including the practical implications of transitioning to it. We look forward to welcoming many of you to these events, which are being held in towns and cities throughout England and Wales between September and December 2013.

The faculty will also be holding its inaugural UK GAAP conference at Chartered Accountants' Hall on 19 November 2013. The

conference – which is exclusively for faculty members – will provide a comprehensive introduction to the new UK GAAP regime and its implications. Speakers will include Roger Marshall, FRC board member and Accounting Council chairman and Matt Blake (pictured), HMRC's commissioners' advisory accountant.

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UK GAAP is dead.

Long live UK GAAP

The faculty's Nigel Sleigh-Johnson and Eddy James talk to Roger Marshall, former ASB chair and now a Financial Reporting Council board member and chairman of its Accounting Council, about the journey that led to a new UK GAAP

The death of UK GAAP has been widely predicted for more than a decade now, with rumours of its demise circulating as long ago as 2002. Back then everybody was talking about a revolution in financial reporting. IFRS were the new kid on the block and it seemed that there was no stopping their march towards global dominance. The EU had just made its landmark decision to require all of its publicly-traded companies to use IFRS when preparing their consolidated financial statements. Meanwhile, the UK government was consulting on whether the use of IFRS should be extended to other companies and the UK standard-setter was concentrating its efforts on achieving convergence between UK standards and those issued by the IASB.

There's no doubt that the obituaries were written a long time ago. But over 10 years later, UK GAAP is still very much alive and kicking. A lengthy and extensive consultation process was finally followed in late 2012 and early 2013 by a clutch of new standards that usher in a new era of financial reporting in the UK. Importantly, while all extant SSAPs, FRSS and UITF abstracts will be replaced, no additional entities will be required to use IFRS.

A LONG AND WINDING ROAD

When we met Roger Marshall, the chairman of the Financial Reporting Council's Accounting Council at its Aldwych offices one sunny July day, he began by explaining why things hadn't worked out as we may have once anticipated.

"We started off by cherry-picking some UK standards and changing them to make them similar or the same as their IFRS equivalents," he says. "But it turned out that this strategy wasn't going to get us very far, as introducing international standards piecemeal created unexpected complications. Countless consequential amendments were needed to accommodate each replacement IFRS-based standard within the existing body of UK GAAP. We realised that it wasn't going to be possible to just

change some of UK GAAP, we needed to find a way to change all of it to ensure it was internally consistent."

By now we had reached the mid-2000s. The IASB's IFRS for SMEs was beginning to take shape and was quickly identified as a possible way forward, as Marshall explains: "It had many attractions. First, it offered a coherent international solution. Second, it was based on the same underlying concepts as existing UK GAAP, so was in many ways similar to it. Third, it was seen as a significant

simplification in that it said in around 300 pages what the increasingly unwieldy UK GAAP book took 3,000 pages to say. And finally some of the criticisms levelled at full IFRS do not affect the IFRS for SMEs which, for example, continues to rely on concepts such as prudence and stewardship."

A colossal consultation process followed. The original proposals would have seen the IFRS for SMEs adopted pretty much wholesale, with the standard only changed where necessary to comply with legal requirements. But as Marshall explains, the feedback they received meant that the standard-setter once again changed tack.

"While there was very limited pushback on the basic principles, there were lots of detailed comments. We began to realise that what was important was to deliver something that was useful to the UK rather than just a carbon copy of the IFRS for SMEs. We were persuaded that it was right to deviate from the IFRS for SMEs provided the final UK standard complied with full IFRS. So, for example, we allowed entities to continue existing practices such as revaluing their fixed assets or capitalising development and borrowing costs. Ultimately a substantial number of changes have been made to the IFRS for SMEs - some fundamental, others more minor."

THE DAWN OF A NEW ERA

So after a decade or so of discussion papers and exposure drafts, the new UK GAAP is finally here. What we have ended up with is a core standard that is based on the IFRS for SMEs but which at

"The IFRS for SMEs had many attractions. It said in around 300 pages what the increasingly unwieldy UK GAAP book took 3,000 pages to say"



DOMINICK TYLER

the same time is very much a UK standard.

Marshall admits that it has “taken a while to get it right” but after a “huge amount of outreach” he is happy with the outcome. He thinks there are lots of good reasons why many preparers will like it too. “It is well-structured, easy to use and will only be updated every three years,” says Marshall. “But at the same time it remains a principles-based standard that allows the exercise of judgement where necessary.”

What differences between the old and new regimes will have the biggest impact on transition will, of course, depend on the individual circumstances of each entity. However, Marshall believes that for many businesses, understanding the treatment of financial instruments may be one of the biggest challenges: “One of the biggest failings of UK GAAP in the recent past is that it did not give any guidance on derivatives accounting even though interest rate swaps, forward contracts and so on are now used not only by large multinationals but also by many medium-sized and even small entities,” he says. “Recognising derivatives on-balance sheet makes sense, but understanding the new approach may involve a steep learning curve for some. The yet to be finalised guidance on hedge accounting and impairment of financial assets may also throw up some challenges and - now that the IASB position on these topics is becoming clearer - we will be shortly consulting on the best way forwards. But in the longer-term the costs involved in complying with the new requirements shouldn’t be that significant.”



SIMPLER STANDARDS

That’s the first time we have heard Marshall use the word “costs”. But we feel sure it is something that many preparers will be worried about as they contemplate moving to the new regime. Reassuringly, Marshall adds: “Though there will inevitably be some short-term implementation costs, our rigorous cost-benefit analysis clearly shows that in the longer-term these will be far outweighed by the potential benefits and cost savings. We must also remember that the new regime offers a proportional solution under which nobody will be required to follow a more complex method of reporting than they currently do.

“Indeed, many entities will be reporting under simpler standards than previously. And that includes subsidiaries of listed entities, which for the first time will be able to benefit from a reduced disclosure framework.”

ALL CHANGE?

It is worth remembering that many entities will see no change in the short-term. Listed groups will continue to use EU-adopted

“Recognising derivatives on-balance sheet makes sense, but understanding the new approach may involve a steep learning curve for some”

IFRS. And small companies will still have the option of using the FRSSSE, which for now will remain fundamentally unchanged. But in the medium- to long-term change is also afoot for the UK’s smaller entities, as Marshall explains: “As the new EU Accounting Directive has now been approved, we’ll soon be launching a consultation on the changes that will be needed to the FRSSSE.”

“We will also be responding to calls for the FRSSSE to be better aligned with the new UK GAAP. In addition we are

also working with the Department for Business, Innovation & Skills on the new micro-entity regulations and their implications for the UK.”

GO FORTH AND IMPLEMENT

But for now it is mainly large and medium-sized private entities that will be affected by the much-heralded new regime. For them, Marshall has a simple closing message: “While the new UK GAAP is not effective until 2015, now is the time to start thinking about implementing it.” Sounds like good advice. ■

A whole new ball game?

Yvonne Lang explains how to work out where you fit into the UK's new financial reporting regime

When in November 2012 the Financial Reporting Council issued FRS 100 *Application of Financial Reporting Requirements* and FRS 101 *Reduced Disclosure Framework*, it marked the beginning of one of the most significant accounting changes in recent times.

The two standards were followed in March this year by FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* - a comprehensive new standard that will apply to the majority of large and medium-sized UK entities in the future. All three new standards are mandatory for periods that begin on or after 1 January 2015.

FRS 100

While FRS 100 is a very short standard, it is central to the new regime as it sets out the financial reporting options that are available for the majority of entities. One of the first things that UK preparers will therefore need to understand is what options are available to them. These are summarised in the table to the right.

Those entities currently required to apply EU-adopted IFRS must continue to do so, but the mandatory use of the international standards has not been extended. However, some entities that previously opted to use EU-adopted IFRS on a voluntary basis may now find FRS 102 will better meet their requirements. Following changes in company law, they can now switch from using EU-adopted IFRS to FRS 102.

While the FRSSSE is currently widely used, there are many entities that meet the criteria to use it that have instead chosen to



	FRSSE	FRS 102	EU-adopted IFRS
Entities eligible for small companies regime	✓	✓ *	✓ *
Entities not small and not required to apply EU-adopted IFRS		✓ *	✓ *
Entities required to apply EU-adopted IFRS			✓

* REDUCED DISCLOSURES AVAILABLE FOR QUALIFYING ENTITIES

use full UK GAAP. Such entities may wish to consider adopting the FRSSSE, which for now remains fundamentally unchanged, as a way of avoiding some of the complexities of FRS 102. Whether this is a longer-term option, however, will depend on the outcome of the ongoing debates about small and micro-companies.

For groups where the parent is required to prepare consolidated accounts in accordance with EU-adopted IFRS there is, and will remain, a choice as to the framework applied to the individual accounts of the parent and/or

subsidiaries. These accounts may either be prepared in accordance with EU-adopted IFRS or UK GAAP. While the consolidation process might be simplified when all entities use the same accounting framework, the extent of disclosure requirements in EU-adopted IFRS has been one of the barriers to its use in the individual accounts.

FRS 101

Following the introduction of FRS 101's reduced disclosure framework, some relief from the disclosure requirements will be available to qualifying entities

One of the first things that UK preparers will need to understand is which options are available to them

that choose to apply the recognition and measurement requirements of EU-adopted IFRS. However, a reduction in the amount of disclosure is not the only factor to be considered when determining what standards to apply. The effects of the different measurement bases between IFRS and UK GAAP on matters such as tax and distributable profits should not be ignored.

FRS 102

For a very large proportion of entities, FRS 102 will be the standard that they will need to apply in their financial statements. Early adoption is possible for any period that ends on or after 31 December 2012, but the amount of preparation that may be required to transition from current UK GAAP to FRS 102 is likely to be a barrier to early adoption by many. However, in some circumstances - for example newly-formed entities - it may prove to be more efficient to apply FRS 102 early. ■



Yvonne Lang is national technical partner at Smith & Williamson LLP

Tread carefully

Stephanie Henshaw highlights some of the major differences between current UK GAAP and the requirements of FRS 102

FRS 102 *The Financial Reporting Standard applicable in the UK and the Republic of Ireland* represents a significant change to the structure of UK accounting standards. It condenses existing UK accounting standards, incorporates new requirements and amends others. The resulting regime is not quite the same as existing UK GAAP, so preparers of financial statements will have to tread carefully in applying it for the first time.

The extent to which companies will have to restate their accounts under FRS 102 will depend on the nature and complexity of their operations, their assets and liabilities and the measurement methods they currently apply. Undoubtedly there will be some companies for whom the new standard does not create significant additional complexity. But others will need to get to grips with some technically demanding issues. Quite a bit of the early comment on FRS 102 has focused on the requirements in section 12 for complex financial instruments, and these are covered in Ken Rigelsford's article on pages 20-21. However, there are a number of other significant changes to measurement and recognition. This article summarises those major differences.

DEFERRED TAX

A potentially significant change for some companies is the requirement that deferred tax be recognised in respect of virtually all timing differences between taxable profit and total comprehensive income at the balance sheet date. This means that companies will now have to recognise deferred tax on revaluations of fixed assets and fair

value adjustments on acquisition.

For companies who have adopted a policy of revaluation previously, this means bringing an additional deferred tax liability onto the balance sheet at transition and adjusting it year-on-year as the valuation is updated. The additional liability could significantly reduce a company's balance sheet total and retained reserves. Whether or not it also reduces distributable reserves will depend on the nature of the revalued asset.

Under current UK GAAP, significant long-term deferred tax liabilities might be mitigated by discounting them. There is no option to do so under FRS 102, and therefore any existing discounting will need to be reversed.

The impact of recognising the deferred tax arising on fair value adjustments on acquisition will depend on when the acquisition arose. For acquisitions under FRS 102, deferred tax will be adjusted via the goodwill on acquisition. Companies making acquisitions between their transition date and the date on which the first financial statements under FRS 102 are prepared will, therefore, need to consider the deferred tax impact of all fair value adjustments. However, deferred tax must also be provided on fair value adjustments that arose on pre-transition acquisitions, not as an adjustment to goodwill but as a reduction in reserves. This may also have implications for distributable profit.

INVESTMENT PROPERTIES

The normal measurement basis for investment properties will continue to be fair value, but under FRS 102 changes in fair value will be reported

through the profit and loss account, not via the STRGL. Investment property companies – and other businesses that hold significant portfolios of investment properties – are therefore likely to see an increase in earnings volatility as a result.

The changes discussed above will mean deferred tax will need to be recognised on valuation adjustments. Investors may assume that any increase in reported profit will result in increased dividends, but this will not be the case where the increase arises solely as a result of valuation adjustments. As a general rule, neither changes to property valuation nor the related deferred tax are treated as realised for distribution purposes.

If there is 'undue cost and effort' associated with establishing the fair value of investment property, companies will be allowed to account for them at historic cost instead. However, the cost model requires depreciation to be provided on all tangible assets except land. A company that adopts the cost model for its investment property will, therefore, report reduced, post-depreciation profit. It should be noted that any additional depreciation charge will adversely affect the company's dividend-paying capacity.

There are other differences from current UK GAAP worth mentioning:

- Property let to and occupied by another group company is no longer excluded from the definition of investment property. Individual company accounts may need to be adjusted to take this into account, although changes will not affect the consolidated accounts of the group.
- Where an interest in investment property is held under an operating lease, FRS 102 permits classification as a finance lease on a property-by-property basis. At the moment, such properties are recognised as assets at their market value. Under FRS 102, both an asset and a related

Companies will have to recognise deferred tax on revaluations of fixed assets and fair value adjustments on acquisition





liability are recorded, using slightly different measurement principles.

USEFUL LIFE OF GOODWILL AND INTANGIBLES

Current UK GAAP requires goodwill and intangibles to be amortised over their estimated useful life, subject to a rebuttable presumption of a maximum life of 20 years or less. Under FRS 102, estimated useful life must not exceed five years, unless there is a reliable basis on which a longer life can be justified. Consequential amendments mean that this change will also affect entities adopting the FRSSE. For companies that currently have a robust basis for using a life in excess of five years, there will be no impact. But for a company that does not, a potentially significant adjustment will be required on transition, and higher future amortisation charges will result.

All intangibles and goodwill are deemed to have a finite life under FRS 102 and so there is no option to undertake annual impairment reviews instead of systematically amortising the asset over its useful life. For companies where the annual impairment review has not led to regular reductions in the carrying value of goodwill or intangibles, there could be a significant additional impact on reported profits (and dividend-paying capacity) from the switch to amortisation.

IDENTIFICATION OF INTANGIBLES ON ACQUISITION

Under current UK GAAP, goodwill arising on acquisition or consolidation is calculated as the difference between the fair value of the consideration given to acquire the business or investment and the fair value of the separable net assets acquired, where 'separable' means that they must be capable of being disposed of or settled separately from

the underlying business. Consequently, some intangibles (such as operating licences, customer contracts etc.) are subsumed within goodwill. FRS 102 requires companies to consider the fair value of 'identifiable' net assets, and an intangible asset is deemed to be identifiable when either it is capable of being separated from the entity or it arises from contractual or other legal rights, regardless of whether those rights are transferrable or separable. Potentially this means that more intangibles are likely to be recognised separately from goodwill.

However, there is an important exception. Intangible assets acquired as part of a business combination will not be recognised separately when they arise from legal or contractual rights and a reliable fair value cannot be established. This is most likely to arise where there is no history or evidence of exchange transactions in similar assets and determining a fair value would depend on immeasurable variables. This means that intangibles will not always be recognised separately from goodwill as part of a business combination.

It is also worth noting that the transitional provisions of FRS 102 specifically state companies should not retrospectively separate from goodwill intangibles previously subsumed within it, unless they elect to apply section 19 in full to pre-transition acquisitions. This exemption only applies to business combinations before transition to FRS 102. For any business combination occurring after transition, separation will need to be considered. Companies planning an acquisition after transition but before the mandatory adoption date of FRS 102 will need to consider both the current and future recognition and measurement requirements so they can make the appropriate adjustments on transition.

DEFINED BENEFIT PENSION SCHEMES

Currently, companies recognise an expected return on plan assets (based on the average rate of return on assets held by the plan expected over the remaining life of the scheme) and an interest cost (reflecting the expected increase in the present value of the plan liabilities when the discount unwinds as the benefits get closer to settlement). In future, they will recognise net interest on



More intangibles are likely to be recognised separately from goodwill

the net defined benefit asset or liability during the reporting period. The effect of this change on pre- and post-tax profit could be significant, with reported profits being reduced in many cases.

Companies that belong to multi-employer schemes, where it is not possible to identify their share of the scheme's assets and liabilities, will continue to account for it as a defined contribution scheme. However, they will have to recognise a liability for committed deficit funding, rather than accounting for contributions only in the period in which they fall due, initially reducing net assets. Both the initial obligation and any subsequent changes to the liability will be recognised in profit or loss.

Under current UK GAAP companies that belong to a group defined benefit pension scheme have been exempt from the requirement to recognise their share of any deficit under the scheme, which is usually recognised only in the consolidated accounts of the group. However, under FRS 102, if there is a contractual agreement or stated policy for charging the scheme

costs to individual members of the group, they will be required to recognise their share of those costs within their own accounts. If there is no such agreement or stated policy, the cost of the scheme is recognised in the accounts of the company that is legally responsible for it (which will often be the parent). As a deficit on a defined benefit scheme falls to be treated as a realised loss, there could be significant implications for a company's dividend-paying capacity if it is obliged to recognise that deficit. Therefore, companies will need to consider whether they should implement a contractual agreement or charging policy before their transition date and what impact that would have on each company's reserves.

HOLIDAY PAY ACCRUALS

FRS 102 requires companies to provide for all obligations to employees. One area of potentially significant change as a result is that of holiday pay.

Currently, many UK companies do not provide in their accounts for the cost of paid annual leave not taken at the year-end. In future they will be obliged to do so. While the financial impact may not be significant in all cases, there will be some companies where significant holiday pay accruals will have to be brought into the accounts, decreasing net assets and reserves, including profits available for distribution. The provision will have to be reviewed and adjusted via profit and loss year-on-year.

ACCOUNTING FOR CHANGES IN STAKE

Currently, when a parent company increases its stake in a subsidiary, the subsidiary's identifiable net assets are revalued to fair value, with a consequent adjustment to goodwill. Decreases in stake result in a gain or loss on disposal.

Under FRS 102, where a change in a parent company's stake does not result in a loss of control it is treated as a transaction with equity holders in their capacity as equity holders. This means there is no impact on profit or loss. ■



Stephanie Henshaw is technical partner for Francis Clark LLP and chair of the faculty board

Lightening the load

FRS 101 Reduced Disclosure Framework provides some welcome relief from the disclosures required by EU-adopted IFRS. **Marianne Mau** explains who qualifies for the new framework and its implications

UK GAAP has long-since allowed subsidiaries to take advantage of exemptions from certain disclosure requirements. The consultation process on the future of UK GAAP not only identified a strong demand for maintaining those exemptions but also for expanding them to entities applying EU-adopted IFRS. So many will welcome FRS 101, which does just that by introducing disclosure exemptions for 'qualifying entities' that otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS.

QUALIFYING FOR FRS 101

A 'qualifying entity' is defined as a member of a group where the parent of that group prepares consolidated financial statements:

- that are publicly available;
- that are intended to give a true and fair view; and
- in which the entity is consolidated.

A charity cannot be a qualifying entity for the purposes of FRS 101.

The disclosure exemptions are available irrespective of whether the consolidated financial statements are prepared under EU-adopted IFRS, UK GAAP or any other GAAP, provided they

FRS 101 affords some significant exemptions from disclosure, which can be selected on an individual basis

are intended to give a true and fair view. They are available not only in the individual financial statements of the subsidiaries, but also those of both intermediate and ultimate parents.

To take advantage of the reduced disclosures, the qualifying entity shareholders must be notified in writing and they must not have objected.

THE DISCLOSURE EXEMPTIONS

Adopting FRS 101 affords some significant exemptions from disclosure, which can be selected on an individual basis. For example, a cash flow statement will not be required, and nor will some of the detailed disclosures relating to share-based payments and business combinations. Certain disclosure exemptions are available only when the parent undertaking makes equivalent disclosure in its consolidated financial statements. See the table to the right for a full list of disclosure exemptions.

Financial institutions are not eligible for the exemptions from the disclosure requirements of IFRS 7 *Financial Instruments: Disclosures* or IFRS 13 *Fair Value Measurement* to the extent that the disclosures relate to financial instruments.

FURTHER IMPLICATIONS OF ADOPTING FRS 101

As noted above, entities adopting FRS 101 otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS. However, legally these are not 'IAS individual accounts'. They are 'Companies Act individual accounts', and certain departures from EU-adopted



Not required by current UK GAAP	Disclosed on a group basis	Other
Cash flow statements (IAS 7)	Share-based payments (IFRS 2)	Third balance sheet (IAS 1)
Key management compensation (IAS 24)	Acquisitions (IFRS 3)	Capital management (IAS 1)
Group related party transactions (IAS 24)	Discontinued operations (IFRS 5)	Standards not yet applied (IAS 8)
	Financial instruments (IFRS 7)	Some comparative data (IAS 1, 16, 38, 40 and 41)
	Fair values (IFRS 13)	
	Impairment (IAS 36)	

IFRS may be required to ensure compliance. Most notably, the Companies Act formats for the balance sheet and profit and loss account will need to be applied, rather than the equivalent requirements of IAS 1 *Presentation of Financial Statements*.

Furthermore, the entity will need to make a statement that the financial statements are prepared in accordance with FRS 101, not EU-adopted IFRS.

For entities moving from current UK GAAP, adopting FRS 101 is more or less equivalent to adopting EU-adopted IFRS and all that entails. The options should be considered carefully; in particular, it should be noted

that similar disclosure exemptions are available under FRS 102.

SHORT(ER) AND SWEET

FRS 101 will be of interest to many individual entities within a group, particularly those reporting under EU-adopted IFRS. It is available for accounting periods ending on or after 31 December 2012, although the conditions that need to be met will require some forward planning before the standard can be adopted. ■



Marianne Mau is a technical manager in the faculty

Are you ready for conversion?

Danielle Stewart looks at some of the most pressing practical implications of the new UK reporting regime

There is not very long to go before all UK entities that are not entitled to adopt the FRSSE will be required to choose between either EU-adopted IFRS, FRS 101's reduced disclosure framework or FRS 102. It is expected that the vast majority will choose the third option.

This new regime is compulsory for accounting periods beginning on or after 1 January 2015, with the date of transition being "the beginning of the earliest period for which the entity presents full comparative information in accordance with [FRS 102]". In practice, for 31 December year-ends adopting from the latest compulsory date, this will mean 1 January 2014. At the time of going to press, this is only three months away.

OBTAINING FAIR VALUES

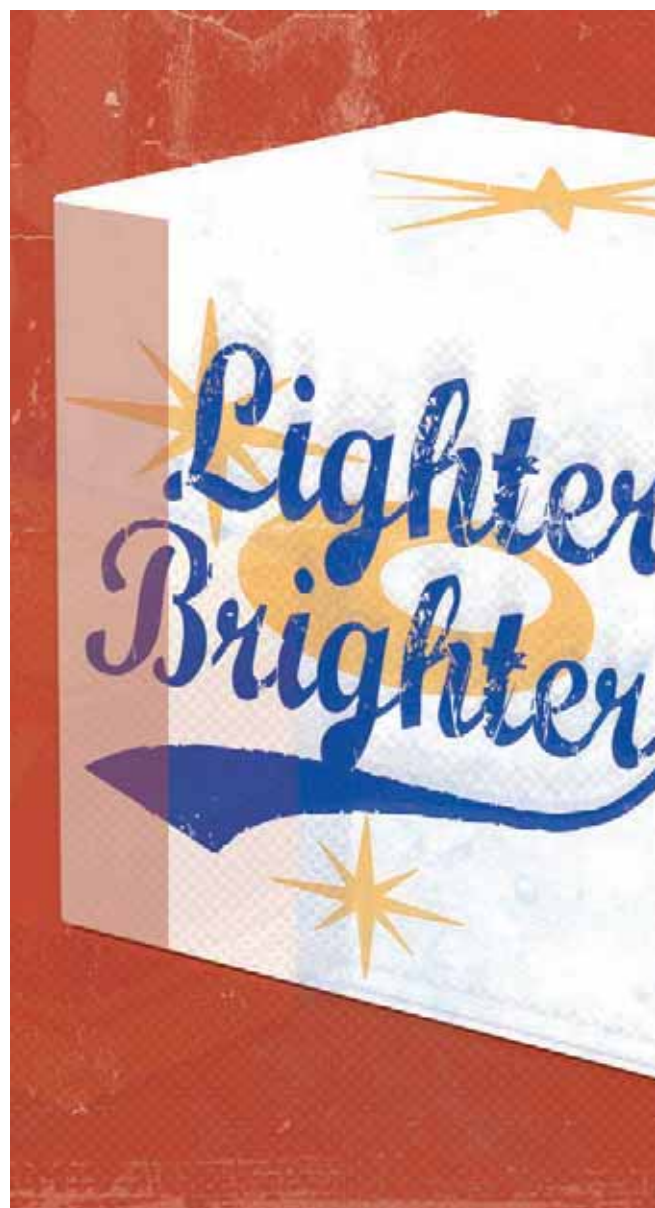
Bearing this in mind, the most urgent point to consider is whether or not your business has any derivatives that will need to be fair valued, because the best way to find out the fair value is to ask the bank or finance house that issued the instrument for it. However, at present, it is very hard to find out the fair values of an instrument from the issuer once the date you need the value for has passed. We hope that in time this might change, as banks realise that their clients will need this information to be available subsequently. But until they do, you should request the fair value of any forward sale or purchase contracts, hedging instruments and interest rate collars or caps in

advance of the relevant valuation date of 1 January 2014.

If you would like help in identifying the financial instruments for which you need fair values, see Ken Rigelsford's article on pages 20-21. I suggest that once you have identified the relevant instruments, you should set up a simple register to record their fair value on each balance sheet date, as well as noting details of how to obtain the relevant fair value.

Paragraph 12.8 of FRS 102 requires changes in fair value to be recognised in profit or loss, which will create greater volatility in your entity's results. This could impact on banking covenants, which is something I will return to later. It will also potentially affect the tax charge, although HMRC does permit the taxpayer to choose whether to have changes in fair values of financial instruments taxed or not. The only problem is this is a one-time choice, and once you have made it, you cannot change it, so you will need to perform some careful calculations to decide whether to opt in or out of what is known as 'the loan relationships and derivatives regime'.

You will need to consider obtaining fair values in December 2013/January 2014 to avoid difficulties in getting hold of the information later



We have talked so far only about the need to obtain fair values on transition for financial instruments. In fact, there are a few other balances for which this issue will potentially apply. Biological assets and agricultural produce may be fair valued under section 34 of FRS 102, although you can choose to carry them at cost if you prefer. Investment properties whose fair value can be measured reliably without undue cost and effort must also be measured at fair value other than at initial recognition, when they are measured at cost.

Clearly in each of these cases, you will need to consider obtaining the values in December 2013/January 2014, to avoid difficulties in getting hold of the information later.



Now is the time to be reviewing the terms of any borrowing to make sure there is no condition which is likely to be endangered by FRS 102 requirements

case scenario, they are looking for a reason to withdraw funding.

My advice if you think this situation might apply to you is to use the fact that you have quite a long time before the problem crystallises to try to do something about it. Adopt FRS 102 as late as possible, and in the meantime try to move to another bank offering more 'FRS 102-friendly' terms.

BANKING COVENANTS

Now is the time to be reviewing the terms of any borrowing to make sure there is no condition which is likely to be endangered by the accounting requirements of FRS 102.

One point which could easily cause a problem is the fact that any changes in fair value of investment properties after initial recognition must in future be recognised in profit or loss. This could cause some uncontrollable downward fluctuations in profit, which might well breach banking covenants.

Clearly this problem will be widespread, so the banks should be expecting their customers to be renegotiating their terms of borrowing. However, this could work to your disadvantage if they decide to demand a higher rate of interest or, in the worst

SYSTEMS AND PROCEDURES

Given that some of the main accounting changes arising from FRS 102 relate to fair values, putting in place procedures to identify them is the main systems implication of the new regime. However, there are a few other aspects that may require record-keeping changes, as follows:

- The requirement to accrue unused holiday or sickness pay means that companies will have to keep a record of employee benefits to allow the accrual to be calculated – although there is a simple way out of the problem ie, change the holiday year to coincide with the accounting year, and don't allow unused holiday to be carried forward.

- The need to potentially separate-out values for customer lists, R&D, unpatented technology, databases and

other intangibles will make the identification of goodwill on acquisitions more complicated. Luckily, section 35 on transition allows a first time adopter not to apply the business combination rules to acquisitions which were already complete before transition, so there is no need to obtain this extra information retrospectively. However, you can't pick and choose – if you restate any past acquisition, you must restate all later acquisitions too.

- Small companies that choose to apply FRS 102 (as opposed to the FRSE) will have to prepare a cashflow statement for the first time. This is unlikely to require any special record keeping as such, but it is something to be aware of when you come to prepare your financial statements.

CONCLUSION

This is the first time in 40 years that UK GAAP reporters have had to make the transition to a new financial reporting regime. However, with a bit of forethought and planning, it should be possible to get through the transition period with the minimum of disruption.

If you are still feeling worried, the Financial Reporting Faculty is always here to give you practical help in this complex world. ■



Danielle Stewart is Baker Tilly's head of financial reporting and a member of the Accounting Council's UK GAAP Technical Advisory Group



Nearly over the finishing line

You may think the publication of FRS 100, FRS 101 and FRS 102 brings the FRC's project on the future of UK GAAP to a close. But as **Jenny Carter** explains, there is still much work to be done

Life at the FRC is never dull. Although we cleared a significant hurdle when FRS 100, FRS 101 and FRS 102 were published, it doesn't mean that our work is done. In fact, as this article highlights, we've got a packed agenda in the months ahead.

The FRC intends to provide entities with as stable a platform as it can. It recognises that there are costs and effort involved in changing accounting policies and disclosures, both for those preparing the financial statements and those using them. It is for this reason that FRS 102 will only be updated every three years.

However, there are a number of activities currently ongoing relating to FRS 102, including:

- updating FRS 102 to reflect international developments in accounting for financial instruments in a manner appropriate for UK and Irish entities, as discussed further in my colleague Deepa Raval's article on page 24;
- finalising FRS 103 *Insurance Contracts*;
- completing material supporting the implementation of FRS 102, including providing oversight to the SORP-making process and issuing staff guidance notes;
- reflecting changes in company law, including the recently revised EU Accounting Directive; and
- addressing implementation queries as they arise with the help of the new UK GAAP Technical Advisory Group, which has been set up to help us identify areas of diversity in practice where action may be required to assist with implementation of FRS 102.

In addition, the FRSE will require updating. The FRC has also been further considering Residential Management Companies (where a draft UITF Abstract was issued by the ASB in 2012). Some of these issues are considered further below.

DRAFT FRS 103 INSURANCE CONTRACTS

In July 2013, the FRC issued FRED 49, draft FRS 103 *Insurance Contracts*. The draft standard applies to entities within the scope of FRS 102 that issue

insurance contracts or financial instruments with a discretionary participation feature. When FRS 102 was issued, it cross-referred to FRS 103 (although work was still to be completed on that standard), so entities were aware that this part of the suite of standards was still outstanding.

The FRC is aiming to provide entities with a single source of financial reporting requirements for insurance contracts. It has developed draft FRS 103 from the international standard IFRS 4 *Insurance Contracts* (in line with its overall aim of consistency with international accounting standards unless an alternative clearly better meets the overriding objective) and has incorporated, either in the draft standard or the accompanying draft implementation guidance, requirements taken from FRS 27 *Life Assurance* and the insurance SORP.

Entities can generally continue with their existing accounting policies for insurance contracts, but there are some areas where FRS 102 and draft FRS 103 may lead to some changes. This is consistent with FRS 102 more generally, where improvements were made in relation to accounting for financial instruments.

The main changes are as follows:

- FRS 102 introduced a definition of an insurance contract to which draft FRS 103 then applies, and entities may find they have contracts they previously thought of as 'insurance' that do not meet the definition. These will be accounted for as financial instruments in accordance with FRS 102.
- Draft FRS 103 will also require entities to provide some disclosures about insurance contracts in addition to those required previously.

The exposure draft is open for comment until 31 October 2013. The FRC will be aiming to finalise FRS 103 as soon as it can, taking into account the feedback from the consultation, because the standard is expected to be effective for accounting periods beginning on or after 1 January 2015, the same effective date as FRS 102.

REVISION OF THE SORPs

A Statement of Recommended Practice (SORP) provides guidance on the application of accounting standards in particular sectors, where there are circumstances or transactions that are not directly addressed in accounting standards. The FRC does not publish SORPs itself, but considers the SORPs prepared by SORP-making bodies, and will issue its 'statement' on a final SORP. Usually this 'statement' will say that a SORP does not contain any points of principle that conflict with current accounting standards.

There are seven SORPs that require updating for the publication of FRS 102, covering authorised funds, charities, further and higher education institutions, investment

trust companies and venture capital trusts, limited liability partnerships, pension funds and registered providers of social housing. The SORP-making bodies are at different stages in the updating process, with the first exposure draft issued by the Charity Commission and the Office of the

Scottish Charity Regulator in July 2013. The remaining exposure drafts are expected over the coming months, with all SORP-making bodies intending to have their SORPs updated in time for implementation of FRS 102 from 2015.

CHANGES IN COMPANY LAW

The revised EU Accounting Directive was finalised in July 2013. Member states have a couple of years in which to implement the new directive. In the UK, the more significant changes will relate to small companies, but there are likely to be some changes required to FRS 102. The FRC will work with the Department for Business, Innovation and Skills (BIS) to ensure that any necessary changes are made consistently with changes in the law.

For small companies, the new

directive has significant implications, particularly for disclosure. As a result the FRSE will require a comprehensive update. The feedback received, following the consultation on FRS 102, was that the FRSE should be made consistent with FRS 102 as soon as possible. The FRC will consult on a new FRSE shortly.

EU Accounting Directives have also identified a sub-set of small companies, micro-entities, for which there are further accounting and reporting exemptions. BIS has consulted on how the 'Micros Directive' should be implemented in the UK. The FRC will consider any necessary amendments to the FRSE to allow micro-entities to take advantage of the legal exemptions.

RESIDENTIAL MANAGEMENT COMPANIES

In 2012, the ASB issued a draft UITF abstract on the subject of residential management companies, as there appeared to be diversity in practice relating to how transactions between the residential management companies and third parties carrying out, for example, maintenance services were being accounted for. Following feedback on the draft abstract, the FRC has carried out more work on this issue and in August 2013 issued FRED 50 outlining draft FRC Abstract 1 and consequential amendments to the FRSE.

The draft abstract only applies where service charges are held under a statutory trust in accordance with the Landlord and Tenant Act 1987. It notes that the residential management company acts as principal in transactions with third-party suppliers, and because the cash held in the trust should not be recognised on the balance sheet of the residential management company, it should be disclosed in the notes to the financial statements. The exposure draft is open for comment until 11 November. ■



Jenny Carter is project director, codes & standards division, at the UK Financial Reporting Council

TAXING TIMES AHEAD

Matt Blake explains how the new regime will affect an entity's tax liabilities

The UK has an accounting-based tax regime, and so most businesses should have a keen interest in understanding not only how any changes to accounting standards will affect the numbers in their accounts, but also how they will then flow through to their tax liabilities.

FRS 100, 101 and 102 are UK accounting standards, so where the tax legislation requires something in accordance with 'generally accepted accounting practice', that will include amounts that have been properly prepared using FRS 100, 101 and 102. Generally accepted accounting practice will also include, as now, amounts properly prepared using the FRSSE and, until FRS 102 becomes mandatory, 'old UK GAAP'.

We have worked with the FRC as it has developed the standards, and I am pleased to say it has issued a set of high-quality standards. They are also more complete and consistent than old UK GAAP.

UNPICKING COMPLEXITIES

That is not to say there are no problem areas, or that some will not become apparent in the future. There are a number of changes that will be applied inconsistently; well-intentioned people may get it wrong; and a few people may also use the accounting standards inappropriately to try to reduce their tax liabilities. HMRC knows that; we understand that preparers can sometimes get it

wrong - in particular when the change is complex. We have a large enforcement and compliance operation that assesses where problems might arise, identifies and intervenes where there is potential non-compliance, and corrects any errors in the calculation of the tax liability.

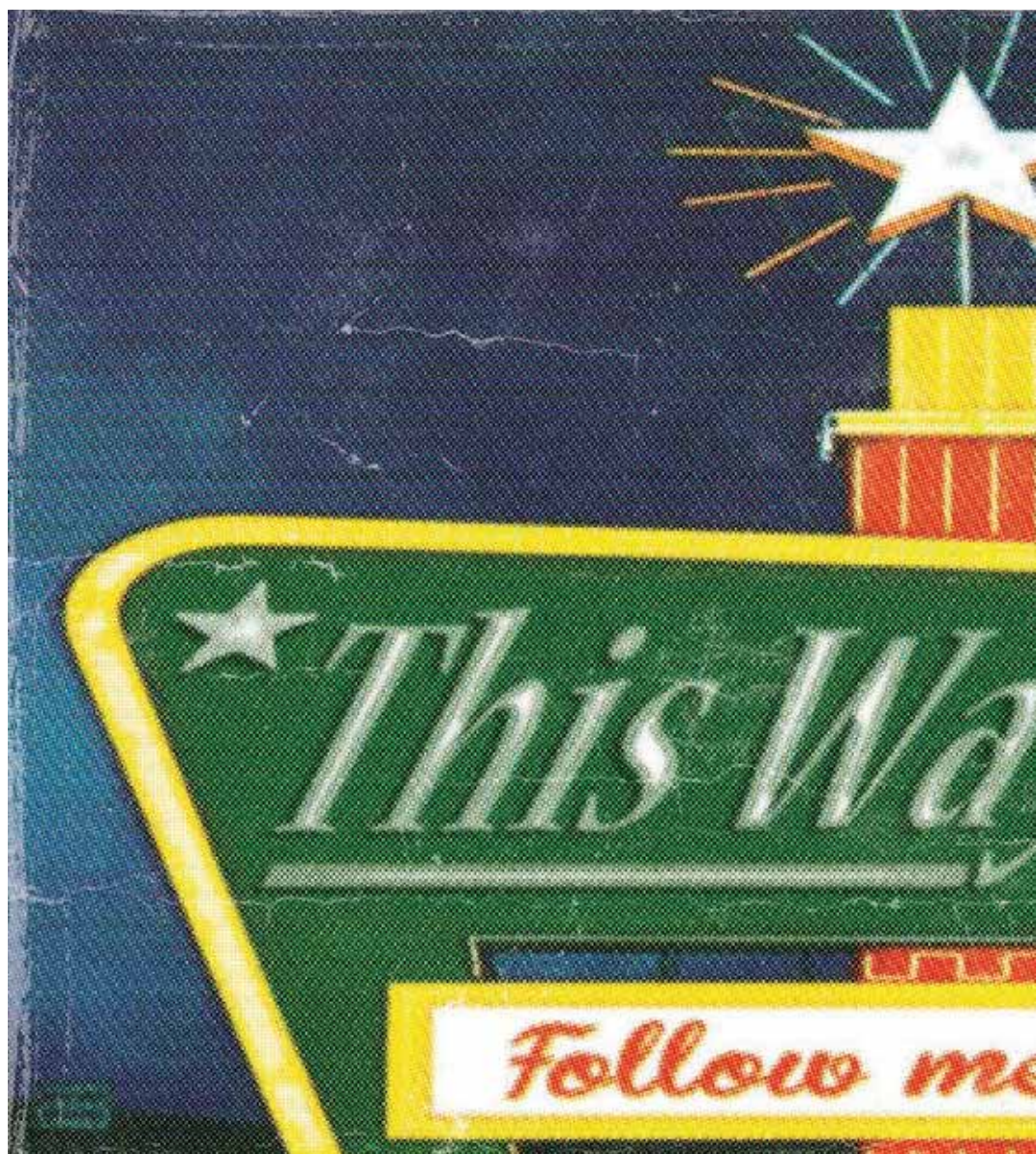
We are in the process of reviewing all of our guidance material for all taxes so that we can reflect the new accounting standards. We are also developing and giving training to about 7,000 people at HMRC who need to understand accounting to develop and apply tax law and to conduct interventions and investigations.

For tax purposes, there is little difference between FRS 101 and EU-adopted IFRS. Since 2005, we

have recognised EU-adopted IFRS accounting for tax purposes. Our expectations of FRS 101 are that it will be mainly applied by subsidiaries of groups that already use IFRS, and so we expect those groups will already have some experience and expectation of the challenge of adopting those policies and the effect on the amounts reported.

Barring some minor amendments, the FRSSE is largely unchanged. We expect that private businesses will probably use either the FRSSE or FRS 102. For the first time, there are significant differences between the FRSSE and 'big GAAP', which will be FRS 102, and we expect relevant businesses will want to take care over their choice.

When accounting standards change, there are two main areas that





Preparers will need to make sure they have considered all of the requirements of FRS 102 and not just those in the headlines

preparers and users need to understand when looking at the effect on tax: the effect on the profit and loss account for the year, with perhaps a different amount being reported as profit before tax; and the transitional adjustment or prior period adjustment.

The main set of differences will be for those businesses that choose to apply FRS 102. There are a number of areas where businesses will need to take time and care, or deal with uncertainty, in applying FRS 102. Preparers will need to take care to make sure they have considered all of the requirements of FRS 102 and not just those in the headlines. FRS 102 is written in an engaging and concise way; one consequence of this is that what could be a significant change for a business might be stated briefly.

NOTES ON DIFFERENCES

The major area that will pose difficulties is the wide scope of financial instruments. When using FRS 102, a business might have a different and unfamiliar accounting policy for any or all of the following: investments, interest-free intra-group debtors and creditors, derivatives (for example, interest rate swaps, forward foreign currency purchases or forward sales of crops), and hedging arrangements. All of these areas are fairly common and, aside from potential impairment, have probably not previously taken up much of the preparer's time when drawing up an old UK GAAP set of accounts. That

could be different with FRS 102. This is also an area where the tax could well be complex.

From our experience of IFRS adoption in 2005, we also expect to see differences in accounting for business combinations: both in recognition, and then

amortisation, of

a wider range of intangibles and in the treatment of goodwill.

SIGNIFICANT CHANGES

There are also a number of other changes that will affect only a smaller number of businesses, but for those businesses these changes may be significant. These include: changes to accounting for revenue recognition, holiday pay, investment properties, agricultural and other biological assets, service concessions, lease incentives, and foreign currencies. There are many more of these more specific areas that preparers need to take care over, including a number of changes for the specific circumstances of public benefit entities.

Adopting the new standards is

likely to involve some transitional adjustment in the accounts to restate the previous year's closing balance sheet to reflect the newly-adopted policies. For transition, this prior period adjustment will be taxed or be relieved against tax in the year of the change if it relates to a change of accounting policy, although if the adjustment is in connection with loan relationships and derivatives it might be spread over 10 years for tax purposes. If it is the correction of an error, then for tax purposes the adjustment should be attributed to the year that the error was made. In general, tax legislation seeks to tax income, and relieve expenses, once and only once.

Any business going through significant and unfamiliar change such as major growth, making an acquisition or disposal, entering new business areas, or taking out new funding, should take particular care to properly apply the relevant standard.

In terms of filing accounts with tax returns, there is work underway which will produce specific UK GAAP FRS 101 and FRS 102 XBRL taxonomies, but in the meantime customers should use the IFRS-UK taxonomy to file accounts using FRS 101 or FRS 102 with HMRC.

Of course, we need to keep the changing accounting landscape in view, and we will continue to engage with and understand the plans and proposals of the FRC and the IASB. There are several that are fundamental to UK accounts - revenue recognition, impairment and leasing - which mean it will continue to be an interesting situation for some time to come. ■



Matt Blake is the commissioners' advisory accountant at HM Revenue and Customs

The biggest challenge

Ken Rigelsford explains that for many companies, FRS 102's new requirements on financial instruments are likely to be the most testing

Under old UK GAAP, only a small minority of companies were required to apply FRS 26 *Financial instruments: recognition and measurement*, the UK equivalent of IAS 39. The rest had only to comply with some fairly rudimentary requirements of FRS 4 *Capital instruments* and company law. That is all about to change. This article highlights some of the key issues.

BASIC OR NON-BASIC?

Sections 11 and 12 of FRS 102 address accounting for financial instruments. Section 11 defines 'basic financial instruments' and sets out how to account for them. Section 12 addresses those financial instruments that are not 'basic' and requires them all to be accounted for at fair value through profit or loss (FVTPL). The dividing line is therefore crucial. Moreover, as it is drawn in a different place to IAS 39, it will be unfamiliar to everyone.

The definition of basic financial instruments in FRS 102 is surprisingly narrow. Leaving aside cash and loan commitments, basic financial instruments are:

- debt instruments (assets or liabilities) that meet specified criteria. They are accounted for at amortised cost using the effective interest method, which is similar to the requirements of FRS 4; and
- investments in non-convertible preference shares and 'non-puttable' ordinary shares or preference shares. These must be accounted for at FVTPL if the shares are publicly traded

or their fair value can otherwise be measured reliably. If not, they are measured at cost less impairment.

Most straightforward bank loans might be expected to meet the criteria for basic debt instruments, but it will be important to carefully analyse the terms and conditions of the loan against the requirements of the standard. There are tight restrictions around the way that interest can be calculated and around the terms for early repayment. A loan which fails to meet all of these criteria will fall within section 12 and have to be accounted for at FVTPL.

It is perhaps surprising to find that some 'basic' financial instruments within the scope of section 11 are nevertheless required to be accounted for at FVTPL. This will be true, for example, of an investment in ordinary shares. However, there is a useful caveat that this is not required if their value cannot be measured reliably. Where there is a quoted price or knowledge of recent transactions, this exemption clearly will not apply, but in other cases more judgement will be required.

While section 11 refers to valuation techniques such as discounted cashflow that might be used to value unquoted equity shares, there may be many cases involving small holdings where there would be no access to the information necessary to apply these techniques. In such cases, it may be reasonable to conclude that reliable measurement is not possible.

Another example of something that

would be at FVTPL within section 11 is an investment in non-convertible preference shares. In this case, it would be difficult to argue that reliable measurement would not be possible because fair value could be determined by discounting the contractual cashflows at a current market rate.

At this point, you may be wondering what happens if the preference shares are convertible. This means that they fall within the

scope of section 12 but the accounting is still at FVTPL, so it really makes no difference whether the shares are convertible or not. The idea in drafting the standard was that entities with simple affairs - perhaps involving holding some simple equity investments - would only have to apply section 11 and could ignore section 12

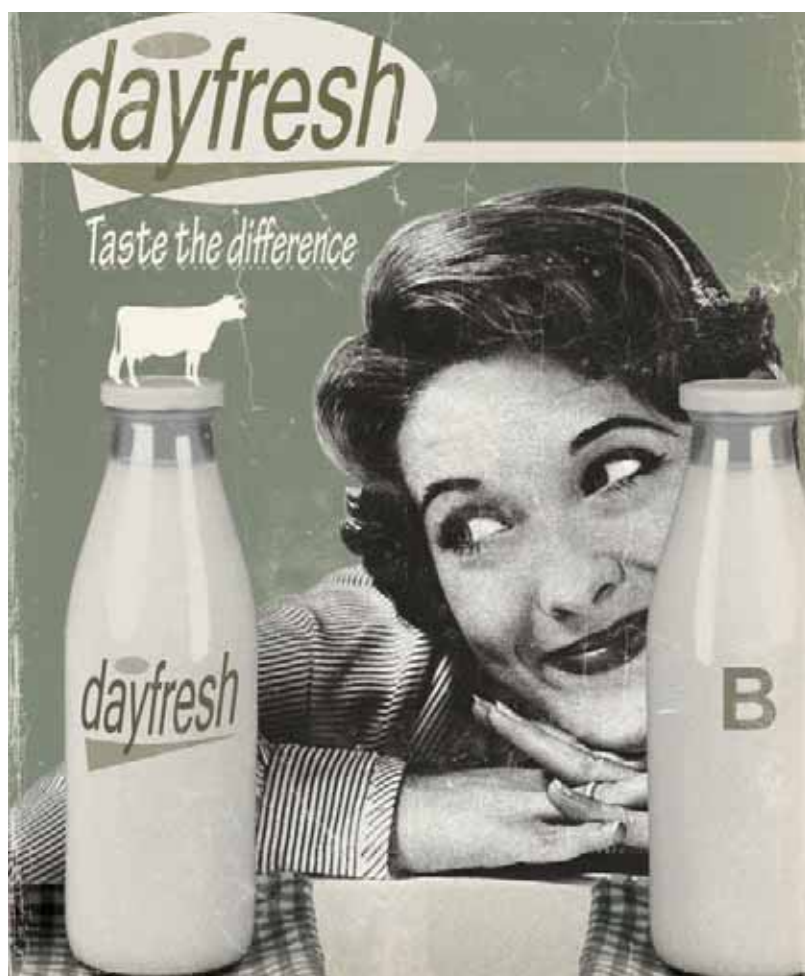
The idea in drafting the standard was that entities with simple affairs would only have to apply section 11

completely. However, given the narrow scope of section 11, this may not be true in practice.

DERIVATIVES AND HEDGE ACCOUNTING

One of the biggest changes under FRS 102 is that all derivatives within the scope of section 12 are accounted for at FVTPL.

This will apply to foreign currency forward contracts, interest rate swaps and other similar contracts that have typically not been recognised at all



To adopt hedge accounting under section 12 of FRS 102 it will be necessary to have hedging documents in place at the date of transition

under old UK GAAP. However, it is important to pay close attention to the scope paragraphs. Derivatives to buy or sell non-financial items such as commodities or inventory do not meet the definition of a financial instrument. However, the scope includes such contracts if they can be settled net in cash (unless they meet an additional 'own use' test) or if they include non-typical features.

Outside the financial services sector, most derivative financial instruments are entered into for hedging purposes. It might therefore be expected that the fair value changes on the derivative would in some way be offset with the changes in value of the hedged item so that the volatility is removed from the profit and loss account. However, the fact that something is an economic hedge does not ensure that hedge accounting will be available under FRS 102. In fact, the circumstances in which hedge accounting is permitted are very narrowly restricted, much more so than under IAS 39.

Fortunately, there are two ways around this. The first is that FRS 102 permits an entity to apply the recognition and measurement requirements of IAS 39 or its replacement IFRS 9 *Financial Instruments*. These standards permit (or will permit in the case of IFRS 9) hedge accounting in a broader range of circumstances. The second solution is to wait until FRS 102 has been updated to reflect a simplified version of the IFRS 9 requirements. The FRC is expected to consult on this shortly after the hedge accounting section of IFRS 9 is published.

Finally, it is worth bearing in mind that to adopt hedge accounting under section 12 of FRS 102, it will be necessary to have some hedging documentation in place at the date of transition, although the requirements are less prescriptive than IAS 39 and FRS 26.

DEBT OR EQUITY

Section 22 of FRS 102 addresses the distinction between liabilities and

equity. The good news is that it is intended to be consistent with FRS 25 *Financial instruments: presentation*, although it is briefer. For all practical purposes, adopting FRS 102 should therefore not result in a change of presentation between liabilities and equity.

CONCLUSION

For most entities, applying sections 11 and 12 is likely to be one of the biggest challenges on adoption of FRS 102. It is vital to begin planning early so that any problem issues can be identified. This article only highlights a few key points and close attention to the detail in the standard will be required. ■



Ken Rigelsford is a director in the UK technical department at Deloitte

Sweet charity

Ray Jones explains why he thinks charities and other public benefit entities should embrace the new financial reporting standard



Charities operate very differently to businesses in the commercial sector. They deliberately seek out obligations and make commitments voluntarily, they acquire property and equipment - not to generate profit for investors but to provide public benefit - and they often hold assets on trust rather than as beneficial owners. Furthermore, charities frequently provide their services for free or below cost and can often only afford to do this because of the public's support through the giving of their time and money.

Before FRS 102 was issued, charity accountants occasionally grumbled that accounting standards neglected their sector by failing to deal adequately with 'non-exchange transactions' such as donations of cash, goods and services and legacies. Some even argued the accounting principles that equated benefit with cash generation failed to recognise business models where service provision, directed at achieving a

charity's purposes, was paramount.

The new standard puts paid to these concerns. For the first time in the history of UK GAAP, an accounting standard recognises these particular characteristics of charities. FRS 102 sends out a clear and welcome message that charity accounting and reporting is now firmly on the agenda of the UK standard-setter.

PUBLIC BENEFIT

First, the standard addresses these past concerns by identifying a category of entities, known as public benefit entities (PBEs), which are defined by their primary objective of providing goods or services for the general public, community or social benefit and where any equity is provided to further objectives rather than to generate a return for investors.

Charities clearly fall within this definition as do the myriad

organisations that fill the space between the state, individuals and commerce. The PBE sector includes general charities, charities in law (including faith groups and independent schools), social housing, further and higher education institutions and other organisations that make up our civil society. It is a sector that is growing in importance to the UK economy and one that is rapidly filling the gaps in service provision as state provision contracts.

DOING BUSINESS DIFFERENTLY

Second, the standard directly addresses incoming resources from non-exchange transactions and other issues commonly faced by charities and other PBEs in a 'specialised activities' section.

The approach adopted also indirectly recognises that the 'business model' of PBEs can impact on their accounting. For example, the standard accepts



that mergers do occur in the PBE sector and that when a PBE 'acquires' another, it is often for nil consideration in a transaction that is in substance a gift, and therefore considered income. This eliminates the need to carry negative goodwill in the group accounts when a charity joins a group and is consolidated. Another example is the option of carrying concessionary loans at the amount paid or received rather than seeing such concessionary funding as a financing transaction that must be carried at amortised costs. These approaches are all welcome and give tacit recognition that PBEs do business differently.

In fact, the new standard even adopts approaches and concepts initially developed in the context of charity accounting through Statement of Recommended Practices (SORPs) and the *Interpretation for Public Benefit Entities of the Statement of Principles*. For example, the accounting approach to recognising funding commitments, an issue faced commonly by grant-making charities, is applied to all entities. Another example is applying the concept of service provision to the calculation of value in use of assets held to provide services. Even the approach to heritage assets was initially developed in the context of the reporting needs of museums and galleries.

A WELCOME STEP FORWARDS

All in all, FRS 102 marks a seminal moment in the ongoing development of charity and PBE accounting. The new standard should be welcomed by charities as it gives the PBE sector recognition and provides reassurance that it will not be ignored in future.

The new standard may also be a catalyst for the development of an international standard for PBEs. In fact, the CCAB is already funding research into what might become an exciting development for charities that operate internationally. ■



Ray Jones is a head of accountancy policy at the Charity Commission

OTHER SPECIALIST ACTIVITIES

Sector experts explain how the new regime will affect entities operating in specialist areas

Universities

The new Further and Higher Education SORP, based on FRS 102 and out for consultation until November 2013, takes effect for 2015-16. Research-intensive institutions in particular will need to analyse funding agreements to determine which of three principal recognition frameworks apply. The requirement to recognise liabilities for deficit recovery plans in multi-employer pension schemes covers the national Universities Superannuation Scheme, reducing net assets substantially across the sector. **Paul Light** is Head of financial reporting at the University of Cambridge

Academies

The main impact will be to recognise new liabilities, including any funding agreements for multi-employer pension schemes in deficit. The changes could also create more volatility with respect to net incoming resources, although the principles around revenue recognition are unlikely to change significantly. There will be some presentational changes, such as the inclusion of realised gains in net incoming resources rather than other recognised gains and losses in the statement of financial activities. We will need to wait for the academies accounts direction, which will be updated to comply with the new regime.

Janette Hulme is a manager in NFP Technical Assurance at Grant Thornton UK

Housing associations

Many registered providers have relatively complex financial instruments, such as 'callables' and other derivative instruments, leading to a new requirement to fair value these instruments. Grants, which were typically carried unamortised on the balance sheet as a deduction from housing properties cost, will now need to be shown gross in the liabilities section, and amortised. And housing properties will face fresh consideration in relation to capitalisation of improvements and the wider definition of investment properties. **Jonathan Pryor** is a partner at Smith & Williamson, a member of the SORP working party and chair of ICAEW's social housing sub-committee

Agriculture

FRS 102 introduces into UK GAAP special rules for agriculture. Following pressure from industry bodies, the final standard allows a choice of either fair value or cost for each class of biological asset and its related harvested product. Indications are that the vast majority of entities will stick with cost, with little or no adjustment on transition. But with 'class' undefined, different policy choices could arguably be made for similar crop/animal types, although swapping is restricted. **David Missen** is an agricultural and private client partner at Larking Gowen Chartered Accountants

Retirement benefit plans

FRS 102's requirements are similar to those required under the current pension SORP, which will continue to provide guidance on the application of the standard and is currently being revised by the Pension Research Accountants Group. The standard will require additional disclosures in relation to investment credit and market risks and investment fair value measurements. Pension liabilities are to be reported in a separate report alongside the financial statements. **Kevin Clark** is an associate partner at KPMG

Extractive industries

FRS 102 incorporates the key features of the international standard, IFRS 6. The 'successful efforts' or 'modified full cost' methods are the two most recognised accounting policies under IFRS 6. These policies do not allow capitalisation of pre-licence costs and may result in cost pools being defined by field or licence. This contrasts with the full cost method under which costs were capitalised to cost pools that may have had a larger geographical footprint. FRS 102 refers to the Oil Industry Accounting Committee's SORP Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities, which was last updated in 2001, so should be applied with caution. **Jimmy Daboo** is KPMG's global head of assurance for gas and oil

Ensuring transparency

Deepa Raval explains how financial institutions will be affected by FRS 102



FRS 102 includes a lengthy definition of a financial institution, which aims to identify those entities whose principal activity is to generate wealth or manage risk through financial instruments. This includes banks, building societies, credit unions, friendly societies, insurance companies, investment funds, pension funds and certain brokers.

The definition determines whether the institution is required to provide the additional disclosures for financial instruments set out in FRS 102. As outlined below, the core accounting requirements for financial instruments for financial and non-financial institutions are the same.

DISCLOSURES

The importance of good disclosure around the activities of financial institutions was highlighted during the financial crisis. FRS 102 contains additional disclosures for financial institutions to ensure that there is transparency around the risks associated with financial instruments held or traded.

The disclosures are based on the requirements of the international standard IFRS 7 *Financial Instruments: Disclosures*, but are more streamlined. They are principles-based and the intention is that financial institutions only provide the disclosures when the information is material.

FINANCIAL INSTRUMENTS ACCOUNTING UNDER FRS 102

At a high level, financial instruments are accounted for as follows under FRS 102:

- Most basic financial instruments are measured at amortised cost.
- Non-basic (ie, more complex) financial instruments are measured at fair value through profit or loss.
- Financial assets measured at amortised cost are assessed for impairment and any losses are recognised as appropriate.
- Entities can choose to apply hedge accounting to derivatives used for hedging purposes.

Overall, FRS 102 offers a simplified approach to

The FRC is keen to avoid entities having to make two sets of changes

accounting for financial instruments compared to the current international standard, IAS 39 *Financial Instruments: Recognition and Measurement*.

THE MAIN CHANGES

The changes to financial instruments accounting will be more fundamental for those financial institutions that are not currently applying FRS 26 *Financial Instruments: Recognition and Measurement*. The main change for those entities will be that derivatives are recognised on-balance sheet and measured at fair value.

FRS 102 also offers entities a choice of applying the recognition and measurement requirements in IAS 39 or its forthcoming successor, IFRS 9 *Financial Instruments*, but with

the benefit of the streamlined disclosures in FRS 102. This option may appeal to those financial institutions that are:

- already applying FRS 26, as that standard is substantially converged with IAS 39 and, therefore, there would be few changes to accounting for financial instruments on transition to FRS 102;
- more complex and prefer the intricacies of financial instruments accounting in IAS 39, such as the separation of embedded derivatives, or macro-hedge accounting; and
- part of a group and would like to align their accounting policies for financial instruments with those of the group (which can also be achieved by using FRS 101).

UPCOMING CHANGES

During the development of FRS 102, the FRC was mindful that the IASB's new standard for financial instruments, IFRS 9, is in the pipeline.

The IASB is moving to an expected loss model for impairment and a hedge accounting model that is more closely aligned to an entity's risk management strategy. Both of these are considered to be improvements from IAS 39 and FRS 102. The FRC is keen to avoid entities having to make two sets of changes in relation to financial instruments accounting within a short period - on transition to FRS 102 on 1 January 2015 and then when IFRS 9 is issued. Therefore, the FRC intends to update the relevant sections of FRS 102 once the IASB finalises its standards.

An exposure draft on hedge accounting is expected from the FRC in the autumn. ■



Deepa Raval is a project director at the Financial Reporting Council

CUTTING RED TAPE

Richard Carter explains that, in an already significant year for UK reporters, there's more to watch out for than just new financial reporting standards

While companies need to begin preparing for the implementation of the new UK GAAP as soon as possible, a number of other regulatory issues also demand their attention.

ACCOUNTING FOR MICROS

The UK has traditionally seen accounts as a tool for enabling the owners of the company to hold the directors to account for their stewardship.

However, in the very smallest companies, the managers, directors and owners are often the same people.

The new micros directive enables the UK government to reduce the burden faced by such businesses by introducing simpler accounts for the more than 1.5 million UK companies that qualify as micro-entities - ie, they meet two of the following three requirements: a balance sheet total not exceeding €350,000, a net turnover not exceeding €700,000 and an average of 10 or fewer employees during the financial year.

Obviously the micro-regime will not be appropriate for all the companies that meet the qualifying criteria. In fact, the micro-exemptions will not be available to companies already excluded from the UK's small company regime. Charitable companies are also excluded. But for those companies that qualify, we plan to simplify the rules around the presentation and publication of the profit and loss account, balance sheet and notes.

THE NEW EU ACCOUNTING DIRECTIVE

The new Accounting Directive was agreed in June 2013 and we now have until July 2015 to turn this into national law. The directive replaces the much-amended 4th and 7th Company Law Directives with one consolidated and significantly changed text.

During the negotiations in Brussels we successfully argued for a number of changes to the original proposals. The final text now includes merger



accounting, the balance sheet format most commonly used in the UK, sensible rules on goodwill, and a relaxation of the maximum harmonisation approach to rules for small companies. Changes in the thresholds mean many companies will be able, if they wish, to take advantage of a reduced reporting regime - moving from 'large' to 'medium-sized' or from 'medium-sized' to 'small'. However, companies that are public interest entities will be treated as large companies, regardless of their size, unless the directive makes explicit provision for them to be treated otherwise. These companies will also need a statutory audit.

There are also new requirements for listed and large non-listed extractives industry companies - those engaged in oil, mineral or gas extraction or the logging of primary forests - to report any payments made to governments. Importantly, these reports are not part of a

company's financial statements. We have already begun discussions with interested parties about the impact of this requirement.

NARRATIVE REPORTING PROPOSALS

In April 2013, the European Commission published proposals to reform narrative reporting in member states. There are two main elements.

The first is for all large companies to disclose their policies on employee matters, respect for human rights, environmental and social issues and anti-corruption and bribery measures, together with information about the risks faced and how they are managed. Where a company does not pursue a policy on one of these matters, it must explain why not.

The second proposal is that quoted companies should include in their corporate governance statement a description of their policy on diversity in terms of age, gender and geographical background, for boards and management. This statement should also include the objectives of the policy, its implementation and results, or explain why there is no such policy.

We will be taking an active role in negotiations in Europe and will be talking to stakeholders to make sure the implications of the Commission's proposals are fully understood and debated. In the meantime, our domestic reforms to narrative reporting - including the requirement for all but small companies to prepare a separate strategic report and for quoted companies to disclose information about their greenhouse gas emissions - come into force for years ending on or after 30 September 2013. ■



Richard Carter is director of business environment at the Department for Business, Innovation and Skills

And finally...

Brian Singleton-Green looks back to those golden days before the advent of accounting standards



In 1970, there were no accounting standards in the UK. Accountants, of course, knew perfectly well how to prepare accounts without the benefit of thousands of pages of standards. Instead, they had hundreds of pages of textbooks and a now defunct form of authoritative guidance called 'Recommendations on Accounting Principles'.

These recommendations were issued by ICAEW from 1942 onwards. Like standards, they were intended to secure greater uniformity in accounting practice. Unlike standards, they were not mandatory. There was also a brief framework of accounting requirements in the Companies Acts and a small amount of case law.

The starting date for the ICAEW recommendations is significant. In 1941, the British government was keen to get as much money from taxpayers as quickly as possible to help pay for the war. To encourage people - and companies - to pay their taxes before they were actually due, the government introduced 'tax reserve certificates', which paid a low rate of interest on early payments of tax. At the time, accountants must have had differing views on how to account for

these novel instruments, and the recommendation *Tax Reserve Certificates*, issued on 12 December 1942, was intended to encourage a uniform approach.

The recommendation was highly prudent in terms of income recognition. It suggested that "accrued interest to the date of the balance sheet should not be taken to credit unless the certificates have been surrendered [and the interest therefore received] before the balance sheet has been signed". The recommendation also betrays accountants' ability to disagree on even the simplest things. It suggests that the interest should be treated as interest and not as a reduction of the tax charge. Presumably some people thought the opposite.

The second recommendation, *War Damage Contributions, Premiums and Claims*, was equally focused on new accounting issues prompted by wartime legislation. Gradually the focus of the recommendations changed, and they became in substance more like codifications of existing best practice, rather than attempts to preclude divergent responses to emerging accounting problems - although there was always an element of the latter.

By the time the series came to an end in

1969, 29 recommendations had been issued - but no more than 16 seem to have been current at any one time. In total, they amounted to 145 pages in a 2009 reprint - even shorter than FRS 102. Purists, however, will point out - quite rightly - that the two are not really comparable. The scope of the recommendations was in some ways much broader than the newly-issued standard, covering not only company accounts but also such matters as trust accounts and accountants' reports for prospectuses.

The recommendations' weak point was that they were not mandatory. As public opinion grew less tolerant of differences in accounting practices, mandatory accounting standards were a logical response. And since their introduction in 1971, the logic of regulation - which dictates that the solution to every perceived problem is more regulation - has led us to where we are today.

In 2009, the distinguished accounting historian Professor Stephen Zeff edited a reprint of the full series, which ICAEW published as *Principles before Standards: The ICAEW's 'N Series' of Recommendations on Accounting Principles 1942-1969*. They were known as the 'N' series because for about 30 years they appeared in the N section of the ICAEW *Members' Handbook*.

When at the time I mentioned to a colleague that we were reprinting the recommendations under the title *Principles before Standards*, his reply was: "And the sequel will be *Standards before Principles*". I couldn't possibly comment. ■



Find out more
Principles before Standards can be downloaded from the ICAEW website.



To obtain a copy email katherine.bassett@icaew.com

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