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IFRS Reduced disclosure framework now available

In a nutshell

FRS 101, the IFRS reduced disclosure framework for qualifying entities, has been published and is now available for 31 December 2012 year ends.

FRS 102, the new UK GAAP standard, is expected to be published early in 2013. Legislation came into force on 1 October 2012 allowing companies that are not required to apply IFRSs by the 'IAS Regulation' more flexibility to change their accounting framework from IFRSs to either FRS 101 or FRS 102.

These developments have far-reaching implications for nearly all UK reporters who will need to start thinking about how the change will impact their financial statements and the wider business considerations of change, including tax, distributable profits, banking arrangements, systems and performance management. Done right, and at the right time, these changes could streamline group accounting and tax processes for the long term.

The big picture

FRS 100 "Application of Financial Reporting Requirements" and FRS 101 "Reduced Disclosure Framework" have been published and can be applied now. FRS 100 establishes rules on how to select the appropriate accounting framework for a particular entity. FRS 101 introduces a new reduced disclosure framework enabling most entities within a group to use the recognition and measurement bases of International Financial Reporting Standards (IFRSs), while being exempt from having to make a number of disclosures required by full IFRSs in their financial statements.

Since 2005 listed groups in the UK have been required to prepare their consolidated financial statements in accordance with IFRSs. Almost all other entities have a choice for their individual and any consolidated financial statements between IFRSs or UK GAAP. Small companies (as defined by the Companies Act 2006), have an additional option of following the Financial Reporting Standard for Smaller Entities (FRSSE). Following the publication of FRS 100 and FRS 101, these choices can be reconsidered.

FRS 100 and FRS 101 are available at www.frc.org.uk

FRS 101 is just the beginning. Almost all UK entities will need to consider their accounting choices and prepare for change between now and 2015.

What choices have I got?

Change is no longer hovering beyond the horizon but coming clearly into view. Companies or groups currently following UK GAAP will need to move to FRS 101, FRS 102 or full EU-adopted IFRSs for periods beginning on or after 1 January 2015, with comparatives required for 1 January 2014 onwards. Early adoption should be possible and of course, companies and groups can alternatively transition to full EU-adopted IFRSs at any time.

Change is required. All companies from 1 January 2015 will need to be using the new standards (FRSs 100, 101 and 102), the FRSSE or full IFRSs.

- **FRS 102:** transition from old UK GAAP to one 250 page standard replacing all the previous SSAPs and FRSs. Whilst there are many similarities there are also some significant differences, for example in the case of financial instruments.

- **FRS 101:** the IFRS reduced disclosure framework is expected to be a favoured option for those groups that already prepare, or wish to prepare, consolidated financial statements under IFRSs as it will enable consistent group accounting policies with reduced disclosure compared with full IFRSs. This option is available to both those qualifying parents and subsidiaries already using IFRSs and to those currently accounting under UK GAAP.

- **Full IFRSs:** this remains an option that can be considered particularly given the new flexibility to revert if wished.

- **FRSSE:** those companies currently eligible to use the FRSSE will continue to be able to do so.

Who is eligible to adopt the IFRS reduced disclosure framework?

Companies can take advantage of FRS 101's reduced disclosure requirements if certain conditions are met:

Companies can take advantage of FRS 101 only if certain conditions are met.

- the company must be a qualifying entity (see below);

- the shareholders of the company must have been notified in writing and make no objection to use of the exemption; and

- the company must state in its financial statements:
  - a brief narrative summary of the exemptions adopted;
  - the name of the parent in whose group financial statements it is consolidated; and
  - from where those group financial statements may be obtained.

Definition of a qualifying entity

A qualifying entity is a member of a group where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and into which that entity is included via full consolidation.

This applies to a parent entity's separate financial statements as well as those of subsidiaries.

> The requirement to notify shareholders in writing applies equally to the parent company if it wishes to use the reduced disclosure framework for its separate financial statements. Listed companies planning on adopting FRS 101 should consider making a statement in their 2012 annual report saying that they will do so unless they receive objections.

Key considerations when choosing your GAAP

Full consideration needs to be given to the transition process.

FRS 101 allows groups with qualifying entities applying UK GAAP to align accounting policies and reduce consolidation adjustments arising from different GAAPs. Groups with minimal consolidation adjustments may not wish to apply the full recognition and measurement requirements of IFRSs.

Financial statements prepared on an IFRS recognition and measurement basis with FRS 101 reduced disclosure will remain "Companies Act accounts" and therefore be subject to applicable legal requirements including the formats and some additional disclosures (see below).

For those qualifying entities already applying IFRSs across the group, the benefits of the disclosure reductions will have to be balanced with the need to change their presentation and consider the legal points that may arise in certain cases. However, there will generally be no changes to recognition and measurement.

Qualifying entities contemplating a move from existing UK GAAP to FRS 101 will face bigger challenges because they will have to apply IFRS 1 on first time adoption of IFRSs. While the group may already have systems in place to capture IFRS consolidation data, it will be important to consider the wider business issues and not to underestimate the scale of the project involved. For example, it is likely that there will be wider effects on tax, banking covenants and distributable reserves.

Those groups currently considering the size and shape of their group structure may want to consider whether rationalising the number of statutory entities within a group before the adoption of the new standards might deliver time and efficiency benefits. Companies should ensure that all impacts are considered and analysed prior to making the change.

What are the disclosure exemptions for a company currently using full IFRSs?

The key areas of reduced disclosure requirements are set out in the following table. Those marked with * require that "equivalent" disclosures (see below) are included in the consolidated financial statements of the group in which the entity is consolidated.

Area	Disclosure exemption
Cash flow statement	Complete exemption from preparing a cash flow statement.
Share-based payments*	Exemption from most of the disclosures required by IFRS 2 except for a description of the schemes and certain details about options exercised in the year and options outstanding at the year end. For a subsidiary company, this exemption applies only to arrangements involving the equity instruments of another group entity. For an ultimate parent, this exemption applies only to arrangements involving its own equity instruments and its separate financial statements must be presented alongside the group consolidated financial statements.
IFRSs issued but not effective	The listing of new or revised standards that have not yet been adopted (and information about their likely impact) may be omitted.
Assumptions and sensitivities significant for an impairment review*	Paragraphs 134 and 135 of IAS 36 require extensive disclosures for each cash generating unit which contains goodwill or an intangible asset with an indefinite life. Exemption is provided from most of these requirements, in particular in relation to assumptions and sensitivities.
Business combinations*	Exemption from many of the disclosure requirements of IFRS 3 for business combinations during the period or after the end of the period. Certain basic disclosures including the consideration paid and a table of assets and liabilities acquired are still required.
Cash flows from discontinued operations*	Exemption from providing an analysis of cash flows relating to discontinued operations.
IFRS 7 Financial instrument disclosures*	Complete exemption from all of the disclosure requirements of IFRS 7. This exemption is not available to a financial institution (see below).
IFRS 13 Fair value measurement*	Complete exemption from all of the disclosure requirements of IFRS 13. Once adopted, IFRS 13 replaces the fair value measurement disclosure requirements of IFRS 7 and extends them to other assets and liabilities. A financial institution (see below) may not use the exemption from IFRS 13 in relation to financial instruments but may use it in relation to other assets and liabilities.
Related party disclosures	Exemption for related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to a transaction is wholly owned by such a member. Also exemption from disclosure of compensation for key management personnel.
Comparatives information	Exemption from comparatives for movements on share capital, PP&E, intangible assets, investment property and biological assets. Exemption from the requirement of IAS 1 to present a third balance sheet in some circumstances.
Capital management	Exemption from the capital management disclosure requirements of IAS 1. This exemption is not available to a financial institution.

Financial institutions

The exemptions from financial instrument and capital management disclosures are not available to a "financial institution" which is defined in FRS 100. The definition is a long list of types of entities such as banks, building societies, credit unions, insurance companies, friendly societies and investment trusts. However, in a change from FRED 46, it goes on to state that the definition includes any other entity whose principal activity is to generate wealth or manage risk through financial instruments. It then explains that this is intended to cover entities that have business activities similar to those listed but not specifically included on the list. It adds that this is not intended to include a parent entity whose sole activity is to hold investments in other group entities.

Financial institutions are not exempt from disclosure exemptions for financial instruments and capital management.

> For some entities it will not be immediately clear whether they fall within the definition and as such be subject to the extended disclosures on financial instruments. We believe that the focus should be on similarity with the entities included on the list. The generation of wealth or management of risk through financial instruments might be seen to apply, to some extent, to many entities which would not be thought of as financial institutions in the ordinary usage of the term. Indeed, the unifying feature of the entities on the list seems to be accepting deposits or holding assets in a fiduciary capacity (i.e. one component of the old "public accountability" definition) rather than the generation of wealth through financial instruments.

What does applying FRS 101 mean in practice?

Under The Companies Act 2006, companies can produce either "IAS accounts" as defined in section 395(1)(b) of the Act (i.e. complying with IFRSs as adopted by the EU) or "Companies Act accounts" as defined by section 395(1)(a) of the Act (i.e. complying with UK accounting standards). Financial statements which are prepared using FRS 101 are considered "Companies Act accounts" under the law. This means that they must comply with all the detailed requirements of Schedule 1 to the Accounting Regulations (or equivalent for certain types of entities such as banks or LLPs).

Changes to legislation mean companies now have more flexibility to move from IAS accounts to Companies Act accounts.

The most significant implication of this is that the income statement and balance sheet must follow the statutory formats. There are also some disclosure requirements which will have to be met. For example, not all of the IFRS 7 financial instrument disclosures can be omitted in practice because some are required to comply with the law.

> The Application Guidance, which forms an integral part of FRS 101, contains quite a long list of possible inconsistencies between IFRSs and the law and suggests that accounting policy changes may be required. However, on closer inspection, most of these circumstances are very unlikely to be material, or even arise, in subsidiary company accounts.

This makes it a bit more complicated than just taking a set of IFRS accounts and ripping out some disclosures and will require more thought for companies. On balance, however, it is likely to be worthwhile for most subsidiary companies to put in the effort now to be able to achieve on-going cost savings.

It is likely to be worthwhile for most subsidiaries to put in the effort now.

There is no requirement, if using FRS 101, for the group financial statements into which the entity is consolidated to be prepared under IFRSs. Some of the disclosure reductions are only available if 'equivalent' disclosures are made in the consolidated financial statements (see * in table above). FRS 100 includes some useful guidance on the meaning of "equivalent" for this purpose which confirms that is acceptable for the consolidated disclosures to be made "in aggregate or in an abbreviated form". The guidance does, however, add that if no disclosure is made in the consolidated financial statements on the grounds of materiality, the relevant disclosures should be made at the subsidiary level if material in those subsidiaries.

> This will not usually present a problem because the consolidated financial statements are always likely to contain some disclosures about, for example, financial instruments and share-based payments. It is clear that the amounts for individual subsidiaries do not have to be separately disclosed. However, care should be taken to ensure that at least some disclosure is provided in all those areas where subsidiaries are using the exemptions that are conditional on equivalent disclosures.

How easy is it to adopt FRS 101?

Prior to October 2012 it would not have been possible for those companies reporting under IFRSs to adopt the reduced disclosure framework as laid out under FRS 101 because a "relevant change of circumstance" (e.g. a delisting or certain changes of ownership) was required to change accounting framework from IFRSs to UK GAAP. However changes in legislation means companies can change from IFRSs to UK GAAP (and FRS 101) every five years without any additional requirements.

Companies that hope to make this change for the 31 December 2012 year end will need to consider the format of their financial statements carefully to ensure that all the specific Companies Act disclosures are included.

> The law requires the directors of a parent company to ensure that, with certain exceptions, its subsidiary undertakings prepare their financial statements using the same accounting framework (i.e. either Companies Act or IAS individual accounts, but not a mixture of the two) unless there are good reasons not to do so. Since most groups will want consistency for administrative convenience, there are likely to be 'good reasons' for any departure such as cost/benefit considerations. It is difficult to envisage the circumstances in which the judgement of the directors that there are good reasons will be challenged or who would make such a challenge. In practice, it will therefore be possible to have some subsidiaries using IFRSs and others using FRS 101.

Accounting implications of FRS 101 for a company moving from current UK GAAP

For a UK GAAP preparer adopting FRS 101, it is likely that there will be changes in the recognition and measurement of a number of items in the financial statements. It is effectively a transition to IFRSs which must comply with IFRS 1. Much of the information needed may already have been prepared for group consolidation purposes if the parent reports under IFRSs. However, this will depend on the particular circumstances.

The table that follows picks out some of the more significant differences in accounting treatment between current UK GAAP and IFRSs. This is not a complete list and, in practice, significant work may be involved in identifying and quantifying all of the required adjustments. The UK GAAP treatment here is under the existing standards rather than FRS 102.

Area	IFRS / FRS 101	UK GAAP
Goodwill & intangibles	Goodwill and indefinite life intangibles are not amortised.	Mandatory amortisation. Assumed maximum useful life is 20 years.
Borrowing costs	Must capitalise if criteria met.	Option to capitalise or expense.
Financial instruments	Complex mixed cost/fair value model involving four asset categories, recycling of gains from equity, separation of embedded derivatives and restrictive hedging rules.	Cost model. Derivatives not usually held on balance sheet. No requirements on accounting for embedded derivatives. No hedging requirements; 'synthetic' hedging of foreign exchange covered by allowing use of contracted forward rates. The above assumes that FRS 26 is not being applied.
Foreign currency	Transactions recorded in functional currency and presented in presentational currency.	SSAP 20 requires use of 'local' currency, providing limited further guidance.
Investment property	Accounting policy choice between cost and fair value through profit or loss (FVTPL) measurement.	Mandatory revaluation to open market value with movements going through STRGL and accumulating in a revaluation reserve.
Business combinations	Acquisition method using a fair value exchange approach – attributable costs are expensed, and adjustments to contingent consideration generally to profit or loss.	Acquisition accounting using a cost of acquisition method – attributable costs are capitalised and adjustments to contingent consideration are made against goodwill. Merger accounting is permitted if criteria are met.

Area	IFRS / FRS 101	UK GAAP
Defined benefit schemes	Treatment depends on whether IAS 19 as amended in 2011 is being applied.	Net liability approach based on the present value of future obligations under the plan. Uses projected unit credit method. Actuarial gains and losses taken through STRGL.
Multi-employer pension schemes	No exemption for group multi-employer schemes; entity accounts for its portion of the obligation.	Exemption for multi-employer schemes allows treatment as DC scheme in some entities (including group schemes).
Income tax	The temporary difference (tax base) approach is used.	The timing difference approach is used.

How can we help?

Deloitte has produced further publications including "Choosing Your GAAP" which looks at the broader implications of changing frameworks, a set of FRS 101 illustrative financial statements "Freeing up the GAAPs" and a set of illustrative financial statements showing the impact of moving from UK GAAP to FRS 102 ("Finding the GAAPs"). Your Deloitte contact would be more than happy to share these with you.

A ukGAAP alert setting out details of draft FRS 102 is available at www.deloitte.co.uk/audit publications

Contacts

If you would like further, more detailed information or advice and to discuss how this will affect you, please contact your local Deloitte partner or:

James Bates
jbates@deloitte.co.uk

Will Smith
willrsmith@deloitte.co.uk

Andrew Downes
adownes@deloitte.co.uk

Amanda Swaffield
aswaffield@deloitte.co.uk

Pippa Booth (Tax)
pbooth@deloitte.co.uk

Stephanie Hurst (Tax)
stehurst@deloitte.co.uk

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

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