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Changing your GAAP
Planning your conversion to the new UK reporting regime

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Introduction

The wait is over; the UK financial reporting landscape is changing. With scant months to go until companies are preparing accounts under a new GAAP for the first time in years, if your business is not already planning for the conversion process, that planning needs to start now.

Under the new regime all entities and groups that are not already required to use IFRSs will be affected by the new UK financial reporting standards to some degree. The full panoply of International Financial Reporting Standards (IFRSs) covers over 3,000 pages. Currently UK GAAP is just short of 2,500 pages. The main new UK financial reporting standard, FRS 102, comes in at under 360 and offers a comprehensive and compact replacement for old UK GAAP. What's more, the new IFRS reduced disclosure framework available within FRS 101 has already proven popular for entities within IFRS groups.

These developments have far reaching implications for nearly all UK reporters who will need to consider 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 new UK reporting standards are effective for periods beginning on or after 1 January 2015, meaning that for most, the date of transition – also known as the 'opening balance sheet date' – has long passed. Many UK entities may already have chosen their new financial reporting framework, but for those who have not, the time to do so is now. This guide provides a route map through the practical issues of who can and should do what, and when, and runs through some of the questions that are arising in practice.

If your business is not already planning the conversion process, it needs to start now.

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What's changed?

Since 2005, listed groups in the UK have been required to prepare their consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs). Almost all other groups and companies have had a choice. They have been able to follow IFRSs or UK GAAP. If they are small (as defined by the Companies Act 2006), they had an additional option of following the Financial Reporting Standard for Smaller Entities (FRSSE). But, for periods beginning on or after 1 January 2015, three new Financial Reporting Standards (FRS 100, 101 and 102) come into force, bringing with them a number of decisions and challenges for all UK entities and groups.

The three new FRSs were developed by the Financial Reporting Council (FRC) to replace current UK GAAP (other than the FRSSE) and introduce an IFRS reduced disclosure framework for subsidiaries and parents within groups.

FRS 100 "Application of Financial Reporting Requirements" sets out rules and guidance on how to select the appropriate accounting framework for a particular entity or group.

FRS 101 "Reduced Disclosure Framework" introduces a new reduced disclosure framework enabling most subsidiaries to use the recognition and measurement bases of IFRSs, while being exempt from having to make a number of disclosures required by full IFRSs, in their individual financial statements. The reduced disclosure framework may also be applied to a parent company's separate financial statements.

FRS 102 "The Financial Reporting Standard Applicable in the UK and Republic of Ireland" is the 'main' standard which replaces current UK GAAP. It is based on the IFRS for Small and Medium-sized Entities (IFRS for SMEs), which was issued by the International Accounting Standards Board (IASB) back in July 2009. The IFRS for SMEs is a much simplified version of full IFRSs and is designed to be used by entities which do not have "public accountability", which means that it is restricted in scope. FRS 102 incorporates a number of changes to the IFRS for SMEs to a) widen the scope, b) ensure the standard complies with UK company law requirements and c) reintroduce a number of options available under full IFRSs and/or existing UK GAAP (see below for more detail).

The FRC has also issued **FRS 103 "Insurance Contracts"**, which is applicable to entities that have chosen to apply FRS 102. It is relevant for entities that have insurance contracts and discretionary participation features and are applying FRS 102. FRS 103 consolidates existing guidance included within the IASB's IFRS 4 *Insurance Contracts*, the existing requirements of FRS 27 *Life Assurance* and elements of the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business (ABI SORP).

FRS 102 also includes a set of disclosure exemptions for qualifying entities preparing individual financial statements. Like FRS 101, this framework enables qualifying entities to exclude certain disclosures from their financial statements, while using the recognition and measurement bases of FRS 102.

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Why did UK GAAP need to change?

Maintaining the patchwork of very old SSAPs, FRSs and UITFs was not desirable in the long term.

FRS 102 provides a comprehensive single financial reporting standard which is intended to cover a broad range of entities in the UK and Ireland. It is much shorter than old UK GAAP and IFRSs, at fewer than 360 pages, and is set out by topic. It reduces complexity and enables easier transition to full IFRSs. The following table shows the main differences in size and structure.

Full IFRSs	Old UK GAAP	FRS 102
Standards numbered as they are published	Standards numbered as they are published, in a variety of formats (FRSs, SSAPs, UITFs)	One standard, organised by topic
Over 3,000 pages	Almost 2,500 pages	Under 360 pages
Updated frequently	Updated infrequently, mainly to incorporate changes to converged standards	Updated every few years to provide a "stable platform"*

* The FRC has made substantial amendments to the financial instruments sections of FRS 102 since its original publication in March 2013. These amendments relate to the classification of financial instruments and hedge accounting and were pre-planned pending the development of IFRS 9 *Financial Instruments* by the IASB. These amendments are reflected in the latest version of FRS 102 which was published in August 2014. The first full review of FRS 102 is planned to take place in 2018.

Is my business affected by the changes?

Groups that are currently required to apply full IFRSs as adopted in the EU will continue to be required to apply full IFRSs. For listed groups this is a requirement of EU law, while AIM groups are required by the AIM Rules to apply full IFRSs.

The FRSSE will continue to be available for small companies in the UK until 2016, when the new EU Accounting Directive must be implemented into UK law. This change in law will bring about a number of changes for small companies, including an increase in size thresholds and simplified disclosure and presentation requirements. As a result, the FRC proposes to withdraw the FRSSE from 2016. Instead, small companies will apply FRS 102 with reduced disclosure and presentation requirements.**

** BIS Consultation Accounting Directive (http://www.gov.uk/government/consultations/en-accounting-directive-smaller-companies-reporting)

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So the new UK standards are directly relevant to those companies currently required or choosing to use full UK GAAP, as well as those entities that have voluntarily adopted IFRSs. These entities include:

- listed parent companies preparing individual financial statements;
- subsidiaries within listed groups preparing individual financial statements;
- all private groups and companies, except those which qualify as small by meeting two of the following three criteria:
  - turnover less than £6.5m (£7.8m gross in groups);
  - balance sheet total less than £3.26m (£3.9m gross in groups); or
  - not more than 50 employees;
- many entities other than companies, for example charities which cannot currently apply IFRSs as a matter of law; and
- for periods beginning on or after 1 January 2016, companies that qualify as small under UK company law (see p3 above).

Where consolidated financial statements are prepared using IFRSs, company law allows a free choice of using UK GAAP or IFRSs for the parent company's separate financial statements. Deloitte research* shows that in 2014, 49% of parent companies were preparing their separate financial statements under IFRSs, with 1% already adopting FRS 101 for their separate financial statements. This means that 50% of companies are still using old UK GAAP in their parent company separate financial statements. Many groups also continue to apply old UK GAAP in their subsidiaries' individual financial statements. Wherever UK GAAP is still being applied, a change in GAAP will be required from 1 January 2015.

The bottom line is this: If an entity or group is not required to use IFRSs, the new UK financial reporting standards will be directly relevant to some degree.

* *Annual reports insights 2014 – Providing a Clear Steer* (October 2014)

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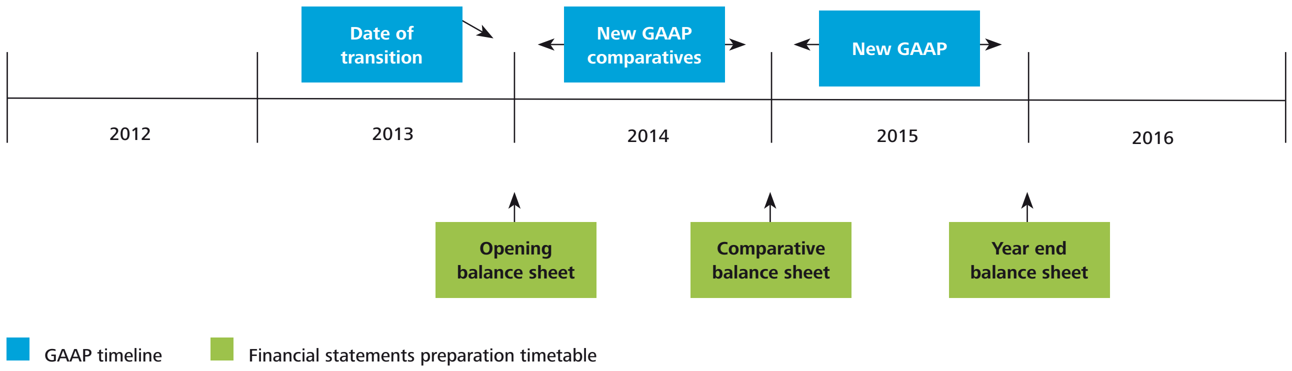
When is this happening?

The new regime is mandatory for periods beginning on or after 1 January 2015. This means that companies will need to be able to prepare the comparatives for that first set of new financial statements under the new regime for periods beginning on or after 1 January 2014. Early adoption is permitted for both FRS 101 and FRS 102; full IFRSs as endorsed in the EU may be adopted at any time.

For small companies, the FRSSE is expected to be withdrawn for periods beginning on or after 1 January 2016.

The timeline below indicates what an effective date of 1 January 2015 means for a company with a year end of 31 December.

New GAAP and audit timeline



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What are my options?

The new UK accounting standards introduce a range of options for companies and groups. The options which are available depend on the circumstances of the company or group in question. The following chart shows the options available for companies and groups in various circumstances.

	EU-IFRS	FRS 101 (EU-IFRSs with reduced disclosure)	FRS 102 (Replacement for old UK GAAP)	FRSSE†
Listed group consolidated financial statements	✓			
AIM-listed group consolidated financial statements	✓			
Listed company individual financial statements	✓	✓*	✓	
AIM-listed company individual financial statements	✓	✓*	✓	
Unlisted group consolidated financial statements (of all sizes)	✓		✓	
Unlisted company individual financial statements of large and medium-sized companies	✓	✓*	✓	
Unlisted company individual financial statements – small companies	✓	✓*	✓	✓

* FRS 101 available for individual financial statements only where the entity meets the definition of a "qualifying entity" – see below.
† FRSSE expected to be withdrawn for periods commencing on or after 1 January 2016 – see p3 above.

As mentioned above, the FRS 101 reduced disclosure framework provides an option for qualifying entities choosing to follow the measurement and recognition bases of EU-adopted IFRSs. It is most likely to be useful to companies preparing individual financial statements within a group which prepares IFRS consolidated financial statements, but the group financial statements into which the entity is consolidated do not have to be prepared under full IFRSs.

There is also a set of disclosure exemptions available to qualifying entities under FRS 102. These exemptions, as well as the exemptions available under FRS 101, are discussed in more detail on the next page.

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Not required by FRS 102 in the first place

What are the disclosure exemptions in FRS 101 and FRS 102?

The disclosure exemptions in FRS 101 and FRS 102 can be summarised as follows:

<table>
<tr><th>FRS 101</th><th>FRS 102</th></tr>
<tr><td colspan="2">Presentation of a cash flow statement and related notes</td></tr>
<tr><td colspan="2">Detailed disclosures on the valuation and effect of share-based payment schemes *</td></tr>
<tr><td colspan="2">Disclosure of key management personnel compensation</td></tr>
<tr><td colspan="2">Financial instruments and fair value disclosures *†</td></tr>
<tr><td>Disclosures on management of the company's capital †</td><td rowspan="6">Not required by FRS 102 in the first place</td></tr>
<tr><td>IFRSs issued but not yet effective</td></tr>
<tr><td>Some assumptions and sensitivities significant for an impairment review *</td></tr>
<tr><td>Comparative information on movements in PPE, intangible assets and investment property</td></tr>
<tr><td>Intragroup related party transactions</td></tr>
<tr><td>Detailed disclosures on business combinations</td></tr>
</table>

* Only available where equivalent disclosures are included in the consolidated financial statements in which the qualifying entity is included
† Not available for financial institutions (see next page)

Some of the disclosure reductions are only available for separate financial statements if 'equivalent' disclosures are made in the consolidated financial statements (e.g. reduced disclosures around share-based payments). These are marked with a '*' in the table above. In practice, the disclosures included within consolidated financial statements prepared under FRS 102, EU-adopted IFRSs, IFRSs as issued by the IASB, US GAAP, Japanese GAAP and other GAAPs which are closely related to EU-adopted IFRSs should satisfy the 'equivalence' test, although the impact and materiality of any differences from EU-adopted IFRSs/FRS 102 should be considered on a case by case basis.

FRS 100 states that if no disclosure is made in the consolidated financial statements on the grounds of materiality, the relevant disclosures should be made at the entity level, if material to that entity.

The financial instruments-related disclosure exemptions are not available to financial institutions (see next page).

Eligibility for the reduced disclosure framework in FRS 101 or the disclosure exemptions in FRS 102

The reduced disclosure framework in FRS 101 or the exemptions in FRS 102 are available if certain requirements are met:

- the company must be a qualifying entity (see below);
- the shareholders of the company must have been notified in writing and, in general, make no objection to use of the exemption (see Q7 below); and

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- 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.

The 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 that member is included in the consolidation. FRS 101 explicitly states that a charity may not be a qualifying entity. FRS 102 contains no such exclusion.

A qualifying entity need not be a subsidiary; a parent company preparing separate financial statements (which may be presented alongside the consolidated financial statements) may also be eligible for the reduced disclosure in respect of those separate financial statements. FRS 101 and the exemptions in FRS 102 cannot be applied to consolidated financial statements.

There is also no requirement for qualifying subsidiaries to be wholly-owned, as long as they are included in the consolidation by the method of full (and not proportionate) consolidation.

The definition of a financial institution and implications

The definition of a financial institution is a long list of entities such as banks, building societies, credit unions, insurance companies, friendly societies and investment trusts.

However, the definition also includes an additional paragraph which extends it to include 'any other entity whose principal activity is to generate wealth or manage risk through financial instruments'. The paragraph then explains that 'this is intended to cover entities that have business activities similar to those listed above but are not specifically included in the list above'. This additional paragraph has caused considerable uncertainty. The unifying feature of the entities on the list seems to be accepting deposits or holding assets in a fiduciary capacity rather than the generation of wealth or management of risk through financial instruments. In its advice to the FRC, the Accounting Council advised that a subsidiary engaged solely in treasury activities for the group is likely to be a financial institution. However, each case will need careful consideration based on the particular facts and circumstances.

Entities that meet the definition of a financial institution cannot take advantage of the reduced disclosures for qualifying entities in FRS 101 (or FRS 102) in relation to financial instruments and the fair value of such financial instruments because such disclosures are considered to be significant to their business. In addition, under FRS 102, financial institutions are also required to make further disclosures about financial instruments.

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Frequently asked questions

When planning for transition to a new financial reporting regime, there will inevitably be a number of questions. Some of the more common queries arising are addressed below.

1. **I haven't chosen my GAAP yet – am I behind the curve?**
   The new standards are effective for periods beginning on or after 1 January 2015. This means that for a company applying UK GAAP with a 31 December year-end, the first new GAAP accounts will be prepared to 31 December 2015 and new GAAP comparatives will be required for the year ended 31 December 2014. The date of transition is the beginning of the comparative period, i.e. 1 January 2014. This is the date at which all of the new GAAP adjustments are processed. In order to do this, it will be necessary to have systems in place to capture the information that is needed to produce 'new GAAP' figures.

   Many companies with a 31 December year-end have already chosen their GAAP and started to plan for the transition process. A number of groups and companies have also opted to adopt the new standards early. For example, some listed groups have opted to apply FRS 101 early in their subsidiary and parent company entity-only accounts to take advantage of the ability to align accounting policies with those applied under IFRSs at the consolidated level. Other companies are transitioning some entities in the group early to test internal processes and systems or to spread the work over two year ends.

   Aside from determining the numbers, early planning and communication with lenders, advisers and stakeholders is essential when planning your GAAP conversion, as the change in GAAP could have wide-ranging effects on the business (see p22 below). Therefore, if you are currently applying UK GAAP and have not already chosen which framework to adopt, it is important to make this decision as soon as possible in order to plan for the transition process.

2. **Do I need to transition all entities in the group on to the new framework at the same time?**
   No. If you still have time to transition early, some entities within a group could move to one of the new accounting frameworks early so as to test the systems and processes in place or to spread the transition work over two year ends, as long as all affected entities transition by the end of the first accounting period beginning on or after 1 January 2015.

3. **Are there any transitional reliefs that I can take to avoid having to apply the new GAAP requirements retrospectively?**
   Companies transitioning to either IFRSs/FRS 101 or FRS 102 for the first time can take advantage of a number of transitional provisions. If adopting IFRSs/FRS 101, the provisions can be found in IFRS 1 *First-time Adoption of IFRSs*. If adopting FRS 102, they are in Section 35 *Transition to this FRS*.

   Both IFRS 1 and FRS 102 contain specific exceptions to retrospective restatement on transition; for example, changes in accounting estimates may not be applied retrospectively. They also both contain optional transitional exemptions covering, among others:

   - an exemption from restating business combinations that took place prior to the date of transition;

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- the option for a subsidiary transitioning later than the parent to use the values included in the consolidated financial statements based on the parent's date of transition (which is particularly useful for entities transitioning to FRS 101 in cases where the consolidated accounts were converted to IFRSs some years ago);
- the option to use fair values and/or revaluations of certain types of asset as 'deemed cost'; and
- the option to use a previous GAAP carrying value as 'deemed cost' for investments in subsidiaries, associates and joint ventures.

However, many of the transitional provisions in FRS 102 are not repeated in IFRS 1, and vice versa. For example, FRS 102 contains a useful exemption providing that dormant companies may continue to use their existing accounting policies on transition to FRS 102 (effectively allowing such companies to remain dormant); IFRS 1 does not contain this provision.

Even where the exemption covers the same area (e.g. business combinations), the specific transitional provisions may differ between frameworks. As part of choosing which GAAP to apply and preparing the opening balance sheet, the transitional provisions in each standard should be considered and understood.

4. My first set of financial statements under the new regime will be 31 December 2015. An acquisition of another business was completed in 2014. Do I need to account for this under my new chosen GAAP?

Yes. Although there are a number of transitional provisions in both IFRSs/FRS 101 and FRS 102 (as explained in Q3 above), these typically apply only to transactions and balances at or before the date of transition. Since this acquisition took place after the transition date of 1 January 2014, the transaction will need to be accounted for under two GAAPs:

- under the *old* GAAP for the financial statements for the year ended 31 December 2014; and
- under the *new* GAAP to arrive at the restated comparative numbers in the financial statements for the year ended 31 December 2015.

5. I understand there is a distinction between IAS accounts and Companies Act accounts. What is this distinction and how does it relate to the new UK reporting regime?

Under UK company law, financial statements can be prepared either in accordance with full EU-adopted IFRSs ("IAS accounts") or in accordance with the requirements set out in law ("Companies Act accounts"). Because of the reduced disclosure requirements, financial statements prepared under FRS 101 are "Companies Act accounts" as they are not prepared in accordance with full EU-adopted IFRSs. As such, they are subject to the additional requirements of UK company law compared to accounts prepared under EU adopted IFRSs. FRS 102 accounts are also "Companies Act accounts".

This means that, amongst other things:

- the profit and loss account and balance sheet are required to follow Companies Act formats rather than IFRS formats;

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- certain disclosures that are required by law would need to be included that are not required under IFRSs; and
- some departures from the measurement and recognition requirements of IFRSs may be necessary in rare circumstances under FRS 101, to avoid conflict with the requirements of the Act.

This makes application of FRS 101 in particular a little more complicated than might be imagined. It is not a case of simply taking a set of IFRS individual accounts and removing some disclosures.

6. Do all subsidiaries of a group need to adopt the same accounting framework?

Under the Companies Act 2006, subsidiaries within a group should adopt the same accounting framework (preparing either "Companies Act accounts" or "IAS accounts", but not a mixture of the two) unless the directors consider that there are good reasons for not doing so. Financial statements prepared in accordance with IFRSs constitute "IAS accounts", while financial statements prepared in accordance with either FRS 101 or FRS 102 constitute "Companies Act accounts" (see Q5 above).

Therefore it appears that some subsidiaries within a group may adopt FRS 101 while others may apply FRS 102 without falling foul of this requirement, but 'good reasons' would be required if any subsidiaries were to adopt IFRSs while others adopted FRS 101 or FRS 102. However, most groups will want consistency for administrative convenience and so for there to be a departure, there are likely to be 'good reasons', such as cost/benefit considerations. It is difficult to envisage the circumstances in which the judgement of the directors that there are good reasons would be challenged or who would make such a challenge.

7. The subsidiaries and ultimate parent company in my group will be adopting FRS 101 in their individual financial statements. How do I notify the shareholders of these entities in accordance with the requirement to do so in FRS 101?

In order to adopt FRS 101 (or the disclosure exemptions in FRS 102) shareholders must have been notified in writing and must make no objection. There is no requirement for explicit shareholder approval. The absence of any objections within the prescribed limits can be taken as approval.

Where the qualifying entity is a wholly-owned subsidiary, this should be fairly straightforward to arrange. In practice, such decisions are nearly always made at group level and imposed on subsidiaries by group management. Auditors will expect to see some evidence that the requirements of the Standard have been complied with although, in practice, evidence of approval by the parent company would meet the substance of the requirement.

However, the requirement applies equally to the parent of a group if it wishes to apply FRS 101 (or the disclosure exemptions in FRS 102) in its separate financial statements. Listed companies planning on applying FRS 101 should consider making a statement in the annual report (or indeed the interim report if sent to shareholders) prior to the year in which it is to be adopted, saying that they will do so unless objections are received. Even if a few objections are received, this parent could still apply FRS 101, provided that the objections do not represent more than 5 per cent of the share capital.

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8. Will I need to give more disclosure under the new regimes?

It depends on which GAAP your business currently applies and which new GAAP is adopted, although it should be noted that in many areas (such as financial instruments) all of the new GAAPs require increased disclosure compared to old UK GAAP. Therefore, it can be expected that for most companies the financial statements will look quite different.

IFRSs contain more disclosure requirements than the other GAAPs on offer. Therefore, for those qualifying entities already applying IFRSs across the group in their individual financial statements, a transition to FRS 101 or FRS 102 is likely to reduce the level of disclosure required. However, because FRS 101 accounts are "Companies Act accounts" under law, they will need to introduce some disclosures that would not have been required under IFRSs in order to comply with UK company law (see Q5 above).

Qualifying entities considering a move from existing old UK GAAP to FRS 101 will face bigger challenges because they will have to apply IFRS 1 on first-time adoption of IFRSs and take on the wider detailed disclosure requirements of full IFRSs, even with the specific disclosure exemptions provided by FRS 101.

For most entities, FRS 102 is likely to require the least disclosure. Although in some areas, such as share-based payments, the disclosure requirements of FRS 102 are lighter than those of old UK GAAP, a number of new disclosures are required (including financial instruments, key management personnel compensation and critical judgements and sources of estimation uncertainty). It is likely that the disclosures given under FRS 102 will, overall, be more extensive than under old UK GAAP. Deloitte has prepared illustrative financial statements which track and explain the changes in disclosure for a company moving from full IFRSs/UK GAAP to FRS 101 and from old UK GAAP to FRS 102. Your Deloitte contact would be happy to share these with you.

9. Can a dividend be made based on my 2014 UK GAAP accounts, even though I know that a change of accounting framework may reduce available distributable profits in the 2015 accounts?

Yes, in certain circumstances. The general rule is that if a dividend is accounted for *and* paid before adoption of the new framework, the effect of the new framework does not need to be taken into consideration in deciding whether or not the distribution can be made.

For example, for a company adopting FRS 102 for its individual accounts for the year ended 31 December 2015 the position is as follows:

- an interim dividend accounted for and paid during 2014 would *not* have to have regard to the adoption of FRS 102;
- any interim dividend not paid until 2015 *would* have to have regard to the effect of adoption of FRS 102; and
- a final dividend for 2014 will not be accounted for until the 2015 accounts and *would* have to have regard to the effect of adoption of FRS 102.

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10. Is it true that the accounting for intercompany loans may change under the new frameworks?

Whichever GAAP is adopted, financial instruments – including intercompany loans – will need to be identified, understood and accounted for in accordance with the requirements of the chosen framework. The impact of the change in GAAP will depend on the terms of the loan, but IFRSs, FRS 101 and FRS 102 all contain specific requirements for accounting for financial instruments that differ from those under old UK GAAP.

Many intercompany balances do not have formal terms. To help understand how to account for such balances, companies should clarify the contractual terms of intercompany loans as soon as possible. Terms such as maturity, repayment schedules and interest charged should be understood as these will affect the required accounting.

For instance, a loan that is interest free and repayable on demand is likely to be relatively straightforward and the accounting may not change at all under the new framework. By contrast, the accounting is likely to change where an intercompany loan has not been made on market terms and is not repayable on demand. The Deloitte GAAP suite of financial reporting manuals addresses this complex area of accounting in greater detail.

11. I have heard that the financial instruments requirements of FRS 102 were changed in 2014 – what were these changes?

In July 2014, the FRC published amendments to two areas of financial instrument accounting in FRS 102: hedge accounting and the classification of debt instruments.

The original hedge accounting requirements of FRS 102 as issued in March 2013 were narrow and did not permit hedge accounting in a number of common scenarios. The new requirements are based on the hedge accounting principles of IFRS 9 *Financial Instruments* and as a result, there will be more opportunities for entities to apply hedge accounting. Because the amendments were only published in July 2014, the FRC also introduced generous transitional provisions around application of hedge accounting for first-time adopters.

The FRC also decided to update the definition of a "basic" debt instrument in FRS 102 at the same time, in response to feedback that the original definition was too restrictive. Following this amendment, more debt instruments will qualify as "basic". This is important as the classification affects the accounting for such instruments (where a debt instrument is not classified as "basic", it will generally need to be measured at fair value through profit and loss).

These amendments are effective from the same date as the rest of FRS 102, i.e. periods beginning on or after 1 January 2015.

12. What will happen to other accounting guidance, such as SORPs?

The majority of SORPs have been updated following the issue of the new UK financial reporting standards. Therefore, entities that currently apply SORPs will, for the most part, still be applying them. The three SORPs that have been confirmed as being withdrawn for periods beginning on or after 1 January 2015 are those for oil and gas, leasing and banking.

Both IFRSs/FRS 101 and FRS 102 contain specific accounting requirements for a number of specialised activities and entities, including extractive industries, retirement benefit plans and service concession arrangements. FRS 102 also contains specific requirements for public benefit entities. These are supplemented by any guidance given in the relevant SORP.

Notes

What about tax?

The tax impacts of transitioning to IFRSs, FRS 101 or FRS 102 are complex and will need careful consideration by entities. The taxation of transitional adjustments, ongoing cash tax implications and tax accounting changes will need to be considered by companies' tax teams.

The immediate impact of transition to a new GAAP is the taxation of transitional adjustments. The tax rules on a change of accounting policy were updated by HMRC in anticipation of the transition to full IFRSs by some companies in 2005. These rules are likely to have a much wider application as the adoption of a new accounting framework will mean that many UK entities will be changing their accounting policies. Some transitional adjustments are taxed in the year of change, some are spread over future years and others will have no immediate tax effect. Entities will need to consider the impact of these adjustments on cash tax payments (taking into account the planned reductions in the main corporation tax rate) and incorporate them into their budgeting and planning activities. HMRC's Accounting and Tax Group continues to review and consider the impact of accounting changes on taxation and it is important for companies to assess the status of legislation in force at their chosen time of transition carefully.

The significance of changing GAAP will arise from its ongoing impact on tax calculations. Entities will need to consider areas where tax follows the accounting and where adjustments are required to move from the accounting treatment to the tax treatment. In many cases the starting point for taxable income is profit or loss per the entity accounts. Where a change of accounting policy affects the recognition of income or expenses, this will have a tax effect. Some groups with entities that previously used the local currency approach permitted by SSAP 20 *Foreign currency translation* may now have foreign exchange movements taken to profit or loss as a result of the more stringent functional currency requirements in IFRSs, FRSs 101 and 102. These increments will be taxable, causing more volatility in cash tax payable on an annual basis unless certain rules can be applied that may mitigate this for tax purposes.

Transitioning to IFRSs, FRSs 101 or 102 may result in the requirement to consider complex areas of tax legislation where this may not previously have been required. For example, there is provision within the tax legislation to eliminate the volatility that arises for accounting purposes where, for instance, assets and liabilities are hedged by derivatives and different methods of accounting are used for the hedged item and the hedging instrument. The law is extremely complex and it is likely that more companies will be required to consider the rules when adopting IFRSs, FRSs 101 and 102 which may increase their costs of compliance. The current rules do not, however, address all scenarios and cash tax volatility will be unavoidable in some situations where tax is left in the default position of following the accounting.

Entities will also need to ensure they use the appropriate taxonomy for their chosen GAAP to submit their accounts in the iXBRL format required by HMRC. Further adjustments may be necessary to ensure a consistent approach with previous years and compliance with the arm's length principle.

Entities should assess the impacts of transition early to avoid unexpected liabilities and cash tax volatility in future years. The impact of the change of GAAP in areas where tax treatment is dependent on old UK GAAP accounting should also be analysed.

Notes

Summary of potential issues for tax

- Taxation of transitional adjustments.
- Potential cash tax volatility.
- Complexity in relation to financial instruments.
- iXBRL formats.
- Cost of tax compliance.

The tax impacts of transitioning to IFRSs, FRS 101 or FRS 102 are complex and will need careful consideration by entities.

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Key changes in accounting and tax

Whether transitioning to IFRSs, FRS 101 (adopting the measurement and recognition bases of IFRSs) or FRS 102, it is likely that there will be a change in the recognition and measurement of a number of items in the financial statements. The detail that follows picks out some of the more significant differences in accounting treatment between old UK GAAP, IFRSs and FRS 102.

The impact of changing GAAP is of course not restricted to accounting. As discussed above, the financial statements themselves are likely to look quite different following a change of GAAP and it is important to bear in mind the practical challenges of changing accounts templates, rewriting accounting policies and identifying the required disclosures. There may also be significant tax consequences – both on transition and subsequently. An indication of the possible consequences for cash tax and the effective tax rate is also given below.

The impact of changing GAAP is not restricted to accounting and it is important to bear in mind the practical challenges as well.

Notes

Area	IFRSs/FRS 101	Old UK GAAP	FRS 102	Cash tax impact	Effective tax rate (ETR)/ deferred tax impact
Goodwill and intangibles	Goodwill and indefinite life intangibles are not amortised.	Acquired intangibles (including goodwill) must be amortised unless judged to have indefinite useful lives. The assumed maximum useful life is 20 years.	Acquired intangibles (including goodwill) must be amortised. The assumed maximum useful life is 5 years, but only in rare cases where there is no more reliable estimate.	Use of a shorter default useful life under FRS 102 (if no reliable estimate) may accelerate tax deductions compared to old UK GAAP and IFRSs/FRS 101. Where there is no amortisation under IFRSs/ FRS 101, deductions will not be available unless an election was made within 2 years of the end of the accounting period in which the asset was acquired.	No impact on ETR where deferred tax is provided on any differences between book and tax amortisation. Impairment of goodwill will give risk to a higher ETR if it is not tax deductible.
Development costs	Must be capitalised if criteria are met.	May be capitalised if criteria are met.	May be capitalised if criteria are met.	Where expensing is possible, this may allow upfront deductibility of certain development costs (not just qualifying R&D capitalised into intangible assets) rather than deferral through the balance sheet.	No impact on ETR where deferred tax is provided on any differences between book and tax amortisation.
Borrowing costs	Must be capitalised if criteria are met.	Option to capitalise or expense.	Option to capitalise or expense.	Where capitalisation is required or chosen, tax deductions will be deferred until the costs are released to profit or loss. However, there is no effect where borrowing costs are brought into account in determining the value of a fixed capital asset/project, as UK tax law allows a deduction for the expense regardless of the accounting.	No obvious impact.

Notes

Area	IFRSs/FRS 101	Old UK GAAP	FRS 102	Cash tax impact	Effective tax rate (ETR)/ deferred tax impact
Financial instruments	Complex mixed cost/fair value model involving four asset categories, recycling of gains from equity, separation of some embedded derivatives and restrictive hedging rules.	Cost model with option to use FRS 23/26/29 (equivalent to full IFRSs). Derivatives not usually held on balance sheet. No concept of embedded derivatives. Practice is to apply 'synthetic' accounting for economic hedges. Guidance on hedging of foreign exchange allows use of contracted forward rates.	In general "basic" financial instruments (e.g. simple bank loans) are measured at cost or at amortised cost using the effective interest rate method. Investments in non-convertible preference shares and non puttable ordinary or preference shares with a reliably measurable fair value (e.g. quoted prices in an active market) are measured at fair value through profit or loss (FVTPL). "Non-basic" financial instruments (e.g. derivatives) are generally measured at FVTPL. Simplified hedging requirements and no requirement to separate embedded derivatives. Generous transitional provisions for hedge accounting. An option to apply IAS 39 or IFRS 9 for recognition and measurement.	Significant effect – amounts taken to profit or loss will generally be prima facie taxable unless the Disregard Regulations apply. Where entities use FVTPL for the first time, there will be an additional compliance burden as they will need to consider the application of the Disregard Regulations. If a taxable restatement arises in the year of transition, entities will need to consider the impact on certain types of financial instruments where the transition amount is required to be spread over 10 years. Entities which previously "matched" foreign exchange movements under old UK GAAP may have to apply the Disregard Regulations for tax purposes as a result of net investment hedging no longer being permitted, for accounting purposes, in respect of investments in foreign subsidiaries.	The ETR is more likely to be volatile where the Disregard Regulations apply if any resulting deferred tax assets are not recognised. Otherwise the ETR will be 'normalised' through deferred tax provisions.

Notes

Area	IFRSs/FRS 101	Old UK GAAP	FRS 102	Cash tax impact	Effective tax rate (ETR)/ deferred tax impact
Foreign currency	Transactions are recorded in functional currency and presented in presentational currency.	SSAP 20 permits use of 'local' currency, providing limited further guidance. Entities can adopt FRS 23 which is the same as IFRSs.	Transactions are recorded in functional currency and presented in presentational currency.	Potentially significant effect where entities have previously used the 'local currency' approach permitted by SSAP 20. The resulting FX movements taken to profit or loss as a result of the functional currency approach will be taxable, causing more volatility in cash tax payable on an annual basis unless certain rules can be applied that may mitigate this for tax purposes.	No ETR impact where any deferred tax is fully provided. If deferred tax assets are not recognised, more volatility will result.
Investment property	Accounting policy choice between cost and FVTPL measurement	Mandatory revaluation to open market value with movements going through the Statement of Total Recognised Gains and Losses (STRGL) and accumulating in a revaluation reserve.	Use FVTPL unless fair value measurement would represent undue cost or effort, in which case cost is permitted.	No effect since investment properties are taxed on a chargeable gains basis.	Deferred tax will be required on all temporary differences including revaluations (more deferred tax calculation required in comparison to old UK GAAP).
Property, plant and equipment	Accounting policy choice between cost and revaluation through other comprehensive income (OCI).	Accounting policy choice between cost and revaluation through STRGL.	Accounting policy choice between cost and revaluation through OCI.	No impact as tax deductions are based on cost and tax law rather than the accounting treatment.	Simplification of deferred tax calculations under FRS 102 compared to full IFRSs if there are no revaluations.

Notes

Area	IFRSs/FRS 101	Old UK GAAP	FRS 102	Cash tax impact	Effective tax rate (ETR)/ deferred tax impact
Business combinations	Acquisition method using a fair value exchange approach. Attributable costs are expensed, and adjustments to contingent consideration generally recognised in 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.	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 for group reconstructions and certain PBE combinations.	Cash tax implications of transaction costs will depend on the nature of the transaction.	Deferred tax arises on business combinations where fair values allocated to assets and liabilities are different to the underlying tax base under IFRS/FRS 101 and FRS 102 due to the use of timing difference 'plus' approach. Where disallowable costs are capitalised, the ETR will reduce.
Group defined benefit pension schemes	No multi-employer exemption for group schemes; a group entity accounts for its portion of the obligation. Multi-employer exemption still available for schemes **not** under common control.	Exemption for multi-employer schemes allows treatment as defined contribution (DC) scheme in some entities (including group schemes).	No multi-employer exemption for group schemes; a group entity accounts for its portion of the obligation. Multi-employer exemption still available for schemes **not** under common control.	No effect since tax deductions available for pensions are driven by the cash payments rather than expenses taken to profit or loss.	No ETR impact where any deferred tax is fully provided. If deferred tax assets are not recognised, more volatility will result.
Cash flow statements	IFRSs: A cash flow statements statement is required in every set of financial statements. FRS 101: Qualifying entities applying FRS 101 are exempt from this requirement.	Exemption for 90%+ subsidiaries, small companies and certain other entities per FRS 1. Other entities are required to prepare a cash flow statement.	Required in every set of financial statements. Qualifying entities are exempt from this requirement.	Not applicable.	Not applicable.

Notes

Area	IFRSs/FRS 101	Old UK GAAP	FRS 102	Cash tax impact	Effective tax rate (ETR)/ deferred tax impact
Income tax	Requires a temporary difference (tax base) approach.	Requires a timing difference approach.	Requires a 'timing difference plus' approach. Timing differences are as in old UK GAAP. Deferred tax is also recognised on fair value differences arising on business combinations in consolidated financial statements.	No impact.	No impact.

This table is not exhaustive and there are a number of other differences which will need to be considered when assessing the effect of changing GAAP.

Notes

Beyond accounting and tax

Converting to a new accounting regime is not just an accounting or tax issue. As well as identifying all the differences already discussed, companies need to consider the impact of moving to a new accounting regime on other areas of the business. Some of the most likely impact areas are given below. Work may be required around group reorganisations, dividend planning and identifying whether there are any potential 'blocks' in groups, reviewing tax arrangements and updating finance systems.

Area of focus	Questions to consider
Systems and reporting	• Has your accounting system been updated to support a revised chart of accounts? • Is the process for tagging statutory accounts under iXBRL updated for the GAAP change? • Can the systems adequately capture all the necessary information needed for new GAAP numbers? • Will the option to adopt FRS 101 enable simplification of the group reporting process? • Are there any accounting differences which require budgets and forecasts to be updated or reworked? • What is the impact on key performance indicators as a result of the change in GAAP? • Has an impact assessment been performed to identify the significant accounting changes?
Remuneration schemes	• Are any bonuses, share-based payments or other remuneration structures linked to financial measures? – If so, do these schemes need to be revisited as a result of the new accounting regime?
Distributable profits	• Will the use of a different GAAP impact on the ability of group companies to pay dividends up through the group structure in future? • Will a pension deficit be recognised, affecting the ability to pay up profits (see 'Pensions' below)? • If reserves are adversely affected, does the capital structure of subsidiaries need to be altered to allow dividend flows through a group?
Staff and training	• Do directors and staff have sufficient knowledge of the content of the new standards to assess the impact of the new GAAP? • Is there sufficient staff expertise and resource to manage the change? • Has training been arranged for key staff to implement the accounting changes or to understand the new numbers?
Group structure	• Which accounting regime do overseas entities follow? • Would a consistent reporting framework (e.g. IFRSs) improve efficiencies in global reporting and comparability between statutory entities? • What opportunities exist to centralise processes and reporting? • Is there an opportunity to rationalise the group structure in order to avoid changing the accounting and tax regime for multiple subsidiaries?
Pensions	• Is there a group defined benefit scheme? If yes, and the multi employer exemption in old UK GAAP has been used historically, which entities in the group will recognise a share of the liability or asset in their individual books under the new regime?

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Area of focus	Questions to consider
Banking covenants and finance	• Does the change impact on the terms of any banking or legal covenants? • Has the impact of the change in GAAP been communicated to lenders and related advisers? • Will any 'earn out', profit-related rent, licencing or similar types of agreements need to be renegotiated to reflect new measures or 'frozen GAAP'?
Risk management	• How will hedging strategies be affected by the new standards? • Depending on choice of GAAP, is relevant hedge documentation in place?
Regulatory impact	• Will assessment of capital adequacy/monitoring requirements need to be carried out?

Notes

Preparing for the change

The concept of changing GAAP will be new to many. For listed groups, the experience of transitioning to full IFRSs in 2005 will not yet have faded from memory – many groups, for simplicity's sake, chose to move only the group financial statements and/or parent company only financial statements rather than tackling the challenge of migrating all group companies. The introduction of FRS 101 and FRS 102 will now mean that a significant majority of companies will reassess their accounting regime, either by choice or out of necessity.

The main lesson from 2005 is that forward planning is vital for a successful transition. Planning in advance means that the transition can be paced, with costs being kept under control and unwelcome surprises being kept to a minimum. If your business is not already planning the conversion process, it needs to start now.

Preparing for the change may involve a number of stages, as set out below.

Stage	Time	What
Choosing your GAAP	Now if not started	• Assess the overall impact of the change on the business. • Consider whether the group could be reorganised or simplified in response to issues such as, for example, tax arrangements, dividend streams or pension schemes. • Assess whether the change in GAAP will create any major issues which require considerable time and effort and commence work on these as soon as possible (e.g. computer systems, which are iXBRL compliant for tax filing purposes, reward packages, earn-outs). • Select the accounting framework to be applied in respect of each affected entity. • Engage with auditors to discuss the impact of the change in regime.
Detailed preparation	Now	• Arrange detailed training for project leaders. • Identify key differences in accounting treatment and select accounting policies under chosen framework. • Assess impacts on tax strategy and compliance. • Assess impact and opportunities in functional areas (e.g. treasury, human resources, investor relations, tax). • Communicate change to key stakeholders in the business. Identify and engage with other key advisers to plan for the change (e.g. auditors, solicitors, valuations experts, actuaries). • Make systems enhancements.
Implementation	2015	• Prepare opening balance sheet and comparatives. • Organise broader staff briefings/training. • Develop template for the financial statements prepared under new framework.

Notes

How can we help?

Deloitte would be pleased to advise on any of the areas touched on in this publication. Professional advice should be obtained as this general advice cannot be relied upon to cover specific situations. Application will depend on the particular circumstances involved.

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:

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Deloitte has published further publications on the new UK reporting regime which your Deloitte contact would be happy to share with you. These include:

- Deloitte GAAP – our comprehensive suite of financial reporting manuals covering UK legal and regulatory requirements, the new UK financial reporting framework and reporting under IFRSs;
- Illustrative financial statements tracking and explaining the changes from UK GAAP and IFRSs to FRS 101 and from UK GAAP to FRS 102; and
- ukGAAP in your pocket – a guide to FRS 102 – a pocket guide explaining the requirements of FRS 102 in comparison to IFRSs and UK GAAP.

Useful links
A number of Deloitte resources and publications on the new financial reporting regime can be found at **www.ukaccountingplus.co.uk**

The new UK financial reporting standards can be found at **www.frc.org.uk**

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