

### Point of view

## New UK GAAP – impact on real estate entities

#### In a nutshell

FRS 102, one of the options available as a replacement for current UK GAAP, has been published and is mandatory from 2015. This point of view summarises the main changes that might affect real estate which are:

- the possible increase in the period of time that you spread operating lease incentives over;
- the revaluation of investment properties reflected through profit or loss, and not the statement of total recognised gains and losses; and
- the bringing of financial instruments on to the balance sheet where the change in fair value is taken through the profit or loss.

All of these changes will impact the net assets of the entity, and may, in turn, have an impact on the timing of tax payments and the deferred tax asset or liability recognised.

#### What's happened?

The Financial Reporting Council has issued FRS 102 ('new UK GAAP') as one of the options available as a replacement for current UK GAAP. The starting point for FRS 102 was the IASB's IFRS for SMEs, hence, new UK GAAP more closely resembles full IFRSs than before. However, the requirements are not identical. In practice this means that when an entity moves either from current UK GAAP to FRS 102 or from full IFRSs to FRS 102 it will need to consider the impact of the relevant set of differences.

#### Points of focus for real estate entities

##### Lease incentives

Lease incentives provided (or received) are recognised over the lease term under FRS 102.

This is a change from current UK GAAP which requires entities to recognise lease incentives over the shorter period of the lease term or until the first rent review. As a result, those that pay or provide lease incentives to their tenants will recognise the associated expense (recorded as a reduction of lease revenues/amortisation of the balance sheet asset) over a longer period of time with potentially higher net revenues in earlier years. This may also lead to higher tax charges in the earlier years.

*FRS 102 is available at [www.frc.org.uk](http://www.frc.org.uk)*

*Go to the March 2013 [ukGAAP Need to Know](http://www.deloitte.co.uk/futureofukGAAP) at [www.deloitte.co.uk/futureofukGAAP](http://www.deloitte.co.uk/futureofukGAAP) for background information*

*Under FRS 102 entities may be required to recognise lease incentives over a longer period*

Whether moving from IFRSs or UK GAAP, entities adopting FRS 102 will need to consider a number of changes.



Those transitioning from current UK GAAP to FRS 102 may be able to take advantage of transitional rules. Any transitional adjustments that are required may lead to one-off tax costs, depending on whether incentives relate to rent-free periods, general cash inducements, or contributions to tenant fit-out costs.

For those currently applying IFRSs, there are no accounting differences in this area.

### Revaluation gains and losses on investment properties

Entities will generally continue to measure their investment properties at fair value under FRS 102.

For those currently applying UK GAAP, the fair value measurement requirement is not new, but revaluation gains or losses will now be recorded directly in profit or loss with direct impact on the net results. Consistent with current accounting, revaluation gains and losses on investment properties will continue to be considered 'unrealised' when determining distributable profits.

*Change of presentation for revaluation gains and losses may have a large impact on entities' reported results*

There will be no difference in treatment of revaluation gains and losses for those currently applying IFRSs and using the fair value measurement option. However, those entities that currently use the cost measurement option will be required to remeasure their investment properties at fair value through profit or loss unless they cannot be measured reliably without undue cost or effort.

### Measurement of properties under development

Current UK GAAP reporters account for investment properties under development at either cost or fair value (through equity). FRS 102 no longer scopes out such properties from the accounting requirements for investment properties and so it will usually be appropriate for them to be measured at fair value through profit or loss.

As a result, this change will affect net assets and net results. Similarly to investment properties, the revaluation gains and losses on development properties are not considered 'realised' when determining distributable profits. Those currently applying IFRSs will be affected in the same way as described above (*Revaluation gains and losses on investment properties*).

*Under FRS 102, investment properties under development held at fair value*

### Deferred tax

FRS 102 introduces requirements for deferred tax that differ in various aspects from the requirements in both current UK GAAP and IFRSs. In respect of investment properties specifically, FRS 102 requires recognition of deferred tax liabilities or assets on the fair value gains or losses arising from the revaluation of investment properties through profit or loss.

*Deferred tax differs in various aspects from both current UK GAAP and IFRSs*

This represents a significant change in comparison to current UK GAAP; the change will affect the real estate entities' net asset positions as well as their net results.

For those transitioning from IFRSs, there will be no change in this area as the requirements for deferred tax on revaluation of investment properties are similar.

### Complex financial instruments

For those who previously reported under current UK GAAP, certain complex financial instruments (for example, derivatives) which have not been recognised may now need to be reflected in the balance sheet at fair value (remeasurement through profit or loss). This will impact the net assets and net results and the tax implications will also need to be considered.

*Financial instrument accounting will be a big change for many entities*

### Timing

FRS 102 applies for periods beginning on or after 1 January 2015 with early application permitted. This may seem a long way ahead, but the opening balance sheet for December 2015 financial statements will be 1 January 2014, and therefore, consideration of the impact of the transition should begin as soon as possible.

### Resources

Keep in mind that certain accounting changes will have wider business implications (for example on the amounts of tax paid, distributable profits, remuneration schemes and loan covenants) that need to be considered in advance.

*More resources available: [www.deloitte.co.uk/futureofukgaap](http://www.deloitte.co.uk/futureofukgaap)*

## Contacts

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