Choosing your GAAP
Plotting your course through the new UK reporting regime

March 2013

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Introduction

The realisation that UK companies are shortly going to have to cope with new rules dealing with the fundamentals of financial reporting would normally cast a pall of gloom over proceedings. This time it shouldn't. 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 comes in at under 340. What's more, the new IFRS reduced disclosure framework should mean further good news for entities within IFRS groups.

All this has been a long time coming, and the arguments have at times been fraught. But the replacement of the numerous UK GAAP FRSs, SSAPs and UITFs with one single comprehensive standard should certainly make life easier. Under the new regime all entities or groups which are not already required to use IFRSs will be affected by the new UK financial reporting standards to some degree.

The final UK reporting standards have been published and can be adopted now. But forward planning is vital for a successful transition. What this guide provides is a route map through the practical issues of who can and should do what, and when. Full implementation is not required until 2015 and that may sound a long way off. But an opening balance sheet will be required from 2014 and early adoption is possible. The planning should start now.

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Notes

What’s changing?

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 a choice. They can choose to follow IFRSs or UK GAAP. If they are small (as defined by the Companies Act 2006), they have 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) will be in force, bringing with them a number of new options for all UK entities and groups.

What are FRS 100, 101 and 102?

The three new FRSs were developed by the Accounting Standards Board (‘ASB’, the predecessor of what is now the Accounting Council of the FRC) to replace current UK GAAP (other than the FRSSE) and introduce an IFRS reduced disclosure framework.

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 was designed to be used by entities which did 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).

FRS 102 also includes a set of disclosure exemptions for qualifying entities preparing UK GAAP 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.

At the time of writing it is expected that FRS 27 *Life Assurance* will be retained whilst the FRC undertakes a separate consultation on the future of insurance accounting. This will take the form of a separate standard: FRS 103.

Notes

Why replace current UK GAAP?

Maintaining the patchwork of very old SSAPs, FRSs and UITFs, is 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 current UK GAAP and IFRSs, at fewer than 340 pages, and is set out by topic, as used in the current FRSSE. It reduces complexity and enables easier transition to full IFRS. The following table shows the main differences in size and structure.

Full IFRSs	Current 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, following a similar structure to the FRSSE
Over 3,000 pages	Almost 2,500 pages	Under 340 pages
Updated frequently	Updated infrequently, mainly to incorporate changes to converged standards	Updated every few years to provide a "stable platform"

While FRS 102's detailed accounting provisions are broadly consistent with the IFRS for SMEs, there are some key differences. Some of these were made by the ASB to retain options available under current UK GAAP that were popular with preparers and users (e.g. the option to revalue fixed assets). Certain topics in full IFRSs have been added by means of cross-reference (e.g. earnings per share and segmental reporting) because the scope of FRS 102 now extends to some entities with public accountability. Other changes have also been made in order to comply with company law.

Notes

Who will be most affected?

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 to the numerous small companies and businesses in the UK, with only some very small consequential changes at this stage, which should not significantly impact those currently using the standard. The Accounting Council expects to consult further on the future of financial reporting for small companies once current European Commission proposals to simplify further financial reporting for small companies have been finalised.*

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; and
- many entities other than companies, for example charities which cannot currently apply IFRSs as a matter of law.

Notes

* The European Commission's Review of the Accounting Directives: http://ec.europa.eu/internal_market/accounting/sme_accounting/review_directives/index_en.htm

Where consolidated financial statements are prepared using IFRSs, company law allows a free choice of using UK GAAP or IFRSs for the company's separate financial statements. Deloitte research* shows that 60% of parent companies now prepare their separate financial statements under IFRSs, leaving a significant minority still using UK GAAP in their parent company separate financial statements. Many groups also continue to use UK GAAP for their subsidiaries' individual financial statements although a few groups have adopted full IFRS for all of their group entities in their individual financial statements.

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.

* "Joined up writing – surveying annual reports" (October 2012)

Notes

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 expected to be available for companies and groups in various circumstances.

	EU-IFRS	FRS 101 (EU-IFRSs- with reduced disclosure)	FRS 102 (Replacement for current 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.

As mentioned above, the FRS 101 reduced disclosure framework provides a new 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. Only one set of accounting records, using IFRSs, need be kept, reducing the burden for subsidiaries previously put off from adopting IFRSs because of the cost of producing additional disclosures such as a cash flow statement, intra-group related party disclosures and financial instrument risk disclosures (see Q4 on page 10 for more detail).

FRS 102 also includes a set of disclosure exemptions. These include existing UK GAAP exemptions, as well as new exemptions for certain matters already reported on a group basis. These exemptions are most likely to be useful to companies preparing individual financial statements within a group which prepares 'full FRS 102' consolidated financial statements, though it is possible that groups preparing consolidated accounts under other GAAPs, including IFRS, US GAAP and Japanese GAAP, may also benefit (see Q6 on page 11 for more detail).

Notes

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; 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.

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.

Notifying shareholders in person

The requirement to notify shareholders in writing applies equally to the parent company if it wishes to use the reduced disclosure framework in FRS 101 or disclosure exemptions in FRS 102 for its separate financial statements. Listed companies planning on adopting FRS 101 should consider making a statement in their next annual report stating that they will do so in a subsequent annual report unless they receive objections.

Notes

Frequently asked questions

When choosing which regime to adopt, there will inevitably be a number of questions.

1. Can companies currently reporting under IFRSs adopt FRS 101 or FRS 102?

Groups which are required by regulation to report under IFRSs must continue to apply IFRSs. For example, listed groups are required by the IAS Regulation to prepare consolidated financial statements under IFRSs and they will continue to be required to do this.

For other entities, current UK law permits either IFRS financial statements (under law these are referred to as "IAS accounts") or "Companies Act accounts". Financial statements which are prepared using FRS 101 or FRS 102 are "Companies Act" accounts under UK law.

Following a change in legislation, UK law now allows a company to change from preparing IAS accounts to Companies Act accounts in the following two situations:

a) following a 'relevant change of circumstance' – e.g. a company becomes a subsidiary of an undertaking that does not prepare its financial statements under IFRSs; or

b) for any reason, provided that there has been no change (other than due to a relevant change in circumstance) from IAS accounts to Companies Act accounts in the last five years.

Therefore, there will be an opportunity for any company which has voluntarily moved to IFRSs to adopt either FRS 101 or FRS 102, due to the relaxation of the law in b) above.

There will be an opportunity for any company which has voluntarily moved to IFRSs to adopt either FRS 101 or FRS 102, regardless of when they transitioned to IFRSs.

Notes

2. What are the implications of FRS 101 accounts being Companies Act accounts?

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 requirements of UK company law.

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;
- certain disclosures would need to be included; and
- some departures from the measurement and recognition requirements of IFRSs may be necessary in rare circumstances, to avoid conflict with the requirements of the Act.

This makes it a little more complicated than simply taking a set of IFRS individual accounts and removing some disclosures, and FRS 101 will require some thought for companies. Deloitte has prepared illustrative financial statements which show the changes in disclosure for a company moving from full IFRSs to FRS 101 ('Freeing up the GAAPs'). Your usual Deloitte contact would be happy to share these with you.

3. Which is the easiest framework for my qualifying entities to adopt – FRS 101 or FRS 102?

For entities with a choice, deciding which accounting framework to choose will depend on a number of factors.

For those qualifying entities already applying IFRSs across the group in their individual financial statements, the benefits of the disclosure reductions available under FRS 101 will have to be balanced with the need to change their presentation and consider the legal points that may arise. However, there will generally be no changes to recognition and measurement, so on balance, FRS 101 is likely to be worthwhile for most subsidiary and parent companies already applying IFRSs.

Qualifying entities considering 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.

Notes

4. What exemptions are available under the reduced disclosure framework and FRS 102?

The disclosure exemptions available in FRS 101 and FRS 102 are very similar – it is simply that FRS 101 is relevant to companies choosing to use the measurement and recognition bases of EU-adopted IFRSs, while the exemptions permitted in FRS 102 are relevant to companies using the measurement and recognition bases of FRS 102.

The key areas where exemptions are available are as follows:

FRS 101	FRS 102
Presentation of a cash flow statement and related notes	Presentation of a cash flow statement and related notes
Detailed disclosures on the valuation and effect of share-based payment schemes*	Detailed disclosures on the valuation and effect of share-based payment schemes*
Disclosure of key management personnel compensation and intragroup related party transactions	Disclosure of key management personnel compensation and intragroup related party transactions
Financial instrument disclosures (see below)*	Financial instrument disclosures (see below)*
Disclosures on management of the company's capital (see below)	*None of these are required in FRS 102 financial statements in the first place*
IFRSs issued but not yet effective	
Some assumptions and sensitivities significant for an impairment review*	
Comparative information on movements in PPE, intangible assets and investment property	
Detailed disclosures on business combinations*	

• Only available where equivalent disclosures are included in the consolidated financial statements in which the qualifying entity is included.

The exemptions from financial instrument and capital management disclosures are not available to a "financial institution" which is defined in the standards (See Q10 below).

5. Will many new disclosures be required under FRS 102 compared to existing UK GAAP?

Many of the differences between current UK GAAP and FRS 102 will result in changes to existing disclosures in the financial statements and it can be expected that for most companies the financial statements will look quite different. Although there are areas where the level of required disclosure has been reduced or simplified, there are also additional disclosures which will need to be made under FRS 102. For example, there will be significant new disclosures required around financial instruments. Even where financial instruments are relatively simple in nature, the disclosure requirements in FRS 102 are more detailed than those under current UK GAAP (for companies that have not adopted FRS 29).

Notes

Other areas where new disclosures are expected include reserves, goodwill, key management personnel compensation and critical judgements.

Deloitte has prepared illustrative financial statements which show the changes in disclosure for a company moving from current UK GAAP to FRS 102 ('Finding the GAAPs'), UK GAAP to FRS 101 ('Aligning the GAAPs'), and from full IFRSs to FRS 101 ('Freeing up the GAAPs'). Your usual Deloitte contact would be happy to share these with you.

6. In order to enable qualifying entities to adopt FRS 101, do the publicly available consolidated financial statements need to be prepared in accordance with EU-adopted IFRSs?

There is no stated requirement, if using FRS 101, for the group financial statements into which the entity is consolidated to be prepared under IFRSs. Likewise, for an entity applying FRS 102 with the disclosure exemptions, the group financial statements into which the entity is consolidated do not have to be prepared under full FRS 102, so group accounts could be prepared under, for example, US GAAP or Japanese GAAP.

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. FRS 100 includes some useful guidance on the meaning of 'equivalent' for this purpose which also confirms that it 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 entity level, if material to that entity.

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

Currently many listed groups choose to prepare their parent company individual financial statements and subsidiary financial statements in accordance with UK GAAP. Under the new standards, individual financial statements of parents and subsidiaries within listed groups may be prepared under full IFRSs or FRS 102. Qualifying entities can also prepare their individual financial statements under the reduced disclosure framework in FRS 101 or take the disclosure exemptions in FRS 102, as explained above.

Current UK law states that a parent company and its subsidiary undertakings must 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), with some specific exceptions, unless there are good reasons not to do so. 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 will be challenged or who would make such a challenge.

Notes

Financial statements prepared in accordance with either FRS 101 or FRS 102 both constitute Companies Act accounts. Therefore, it appears that some subsidiaries within a group may adopt FRS 101 (based on IFRSs) while others may apply FRS 102 (UK GAAP), without recourse to the 'good reasons' exception.

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

The majority of SORPs will remain in use and will be updated following the issue of FRS 102 in its final form. Therefore, entities which currently apply SORPs will, for the most part, still be using them. The three SORPs that have been confirmed as being withdrawn when FRS 102 becomes effective are those for oil and gas, leasing and banking segments.

In March 2011, the ASB issued an exposure draft (FRED 45) proposing a separate financial reporting standard for public benefit entities (PBEs). Following the responses received to that exposure draft, it was decided that it would be better to incorporate specific requirements for PBEs into the main financial reporting standard, rather than providing a separate standard. Accordingly, there is now a section within FRS 102 which specifically addresses accounting for PBEs.

FRS 102 also contains specific accounting requirements for a number of other specialised activities and entities, including extractive industries, retirement benefit plans and service concession arrangements. These will be supplemented by any guidance given in a relevant SORP, where there is one.

9. Is early adoption available?

FRSs 100, 101 and 102 have now been issued in their final form. FRSs 100 and 101 may be adopted early without restriction. FRS 102 is available for early adoption for periods ending on or after 31 December 2012.

While for entities and groups where the parent and subsidiary companies have already adopted full IFRSs in their individual financial statements transition to FRS 101 is a relatively straightforward exercise, others considering adoping FRS 101 should be aware that the transition process and impact will require significantly more forethought and consideration, given that it is effectively a transition to the requirements of full IFRSs, albeit with some disclosure reductions.

Likewise, an early transition to FRS 102 will require consideration of the impact of the new requirements. Some factors that may impact the timing of adoption include the change of tax rates, availability of iXBRL chart of accounts for FRS 102 and the fact that IFRS 9 has not been finalised (see page 24).

Notes

10. Which entities fall into the scope of a financial institution?

The definition of a financial institution comprises a long list of types of entities such as banks, building societies, credit unions, insurance companies, friendly societies and investment trusts. It also includes retirement benefit schemes. However, the definition goes on to state that it is intended to include "any other entity whose principal activity is to generate wealth or manage risk through financial instruments". It explains that this is intended to cover entities that have business activities similar to those listed but not specifically included on the list. The definition also adds that this is not intended to include a parent entity whose sole activity is to hold investments in other group entities.

In the Accounting Council's 'developments by month' published on the FRC's website, it is suggested that the extension of the definition is intended to capture certain funds that were not caught by the definition of investment funds. Given this, we believe that the focus should be on similarity with the entities included on the list. 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.

Since entities which meet the definition of a financial institution are required to provide additional disclosures around financial instruments, we believe it should be the case that financial instruments are relevant to the company's activities. Otherwise, the requirement to make those additional disclosures would result in additional information in the accounts which is not all that useful to users.

11. Can a distribution be made based on current UK GAAP accounts, in the knowledge that a change of accounting framework may reduce available distributable profits?

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.

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 continue to review and consider the impact of accounting changes on taxation and further changes to legislation may occur between now and the mandatory adoption date. Therefore, it is important for companies to assess the status of legislation in force at their chosen time of transition carefully.

The longer term 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.

Notes

Thin capitalisation and transfer pricing calculations may also be affected by a change of GAAP where the starting point for the calculation of arm's length prices is by reference to results in the statutory financial statements. 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 current UK GAAP accounting should also be analysed.

Summary of potential issues for tax

- Taxation of transitional adjustments.
- Potential cash tax volatility.
- Complexity in relation to financial instruments.
- Thin capitalisation calculations.
- Transfer pricing calculations.

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

Notes

Key areas of accounting and tax impact

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 current UK GAAP, IFRSs and FRS 102.

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

Notes

Area	IFRS/FRS 101	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 (incl. goodwill) must be amortised. The assumed maximum useful life is 5 years, if there is no more reliable estimate.	Use of a shorter default useful life under FRS 102 (if no more reliable estimate) may accelerate tax deductions compared to UK GAAP and IFRS/FRS 101. Where there is no amortisation under IFRS/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 revenue 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	IFRS/FRS 101	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.	"Basic" financial instruments (e.g. simple bank loans) are measured at cost or at amortised cost using the effective interest rate method. Equity instruments with a reliably measurable fair value (e.g. quoted prices in an active market) are measured at fair value through profit or loss (FVTPL). Complex financial instruments (e.g. derivatives) are measured at FVTPL. Simplified but restrictive hedging requirements and no requirement to separate embedded derivatives. An option to apply IAS 39 or IFRS 9 for recognition & measurement (but retaining reduced disclosure).	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 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	IFRS/FRS 101	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 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 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	IFRS/FRS 101	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.
Multi-employer pension schemes	No exemption for multi-employer or group schemes; a group entity accounts for its portion of the obligation.	Exemption for multi-employer schemes allows treatment as defined contribution (DC) scheme in some entities (including group schemes).	Exemption for multi-employer schemes allows treatment as DC scheme, but no exemption for group schemes (i.e. a group entity accounts for its portion of the obligation). Entities able to take exemption will still need to recognise a liability where they have entered into an agreement to fund a deficit.	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.

Notes

Area	IFRS/FRS 101	UK GAAP	FRS 102	Cash tax impact	Effective tax rate (ETR)/deferred tax impact
Cash flow statements	IFRS: A cash flow 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.	No impact.	No 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 existing UK GAAP. Deferred tax is also recognised on fair value differences arising on business combinations in consolidated financial statements.	Not applicable.	'Temporary difference' and 'timing difference plus' approaches may give rise to greater deferred tax balances in consolidated financial statements.

This table is not exhaustive and there are a number of other differences which will need to be considered when choosing which GAAP to follow.

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 will 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. Companies may wish to initiate certain work now and make plans in advance of the conversion date to ensure that the foundations for a smooth transition are in place. 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	• Can accounting systems currently in place support a revised chart of accounts? • How will the change of GAAP require changes to the process for tagging statutory accounts under iXBRL? • Will the option to adopt FRS 101 enable simplification of the group reporting process? • How will management reporting and forecasting be affected? • Are there any accounting differences which require budgets and forecasts to be updated or reworked? • How will the different accounting regime impact on key performance indicators?
Remuneration schemes	• Are any bonuses, share-based payments or other remuneration structures linked to financial measures? • If so, will these schemes need to be revisited as a result of the new accounting regime?
Distributable profits	• How will the new accounting regime impact on dividend payments up through a group structure? • Will a pension deficit be recognised, affecting the ability to pay up profits (see 'Pensions' below)? • If reserves are adversely affected, will 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 be able to make an informed decision as to which regime to adopt? • Is there sufficient staff expertise and resource to manage the change? • Will training be required 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. IFRS) 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?

Notes

Area of focus	Questions to consider
Pensions	• Is there a group defined benefit scheme? If yes, and the multi employer exemption in FRS 17 is used, which entities in the group will recognise their share of the liability or asset on their individual books under the new regime? • How will the new standards impact on accounting for any pension schemes (particularly group defined benefit schemes no longer able to take the multi-employer exemption under FRS 102)?
Banking covenants and finance	• How will the change impact on the terms of any banking or legal covenants? • 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?
Regulatory impact	• Will assessment of capital adequacy/monitoring requirements need to be carried out?

Notes

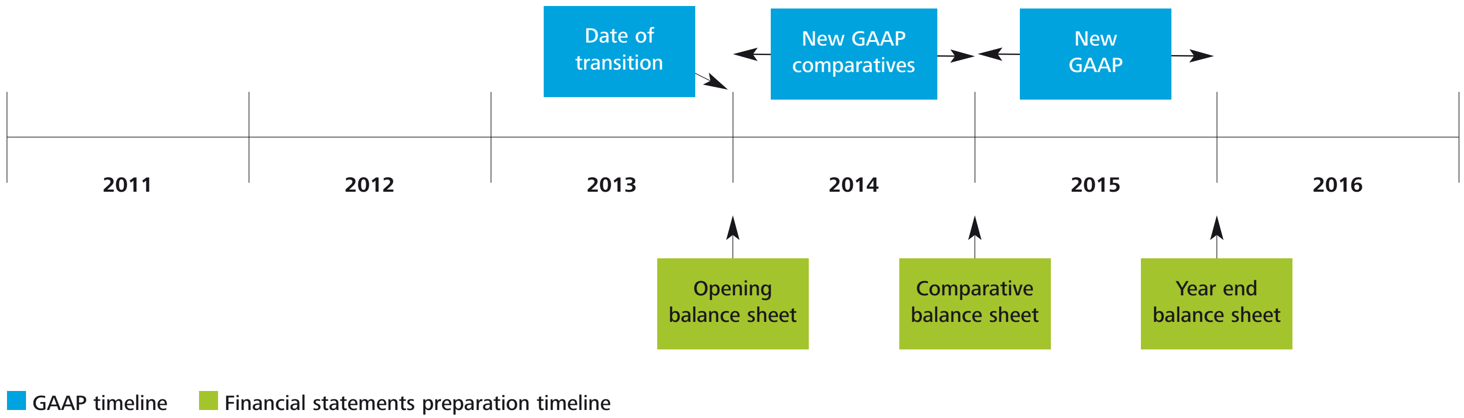
When is this happening?

The new regime will be 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 for periods beginning on or after 1 January 2014. Early adoption is permitted, as discussed earlier in this document. This may be particularly attractive for those considering adoption of FRS 101.

The sections in FRS 102 on financial instruments are expected to be changed again in the next few years. This is because parts of them (dealing with hedging and impairment) are based on the IFRS for SMEs but are expected to be brought into line with IFRS 9, when the relevant parts of that standard have been finalised. The FRC intends that FRS 102 will be updated to align with IFRS 9 in these respects but will consult separately on this. There will also be a further consultation on the FRSSE to reflect the final outcome of European proposals to reduce reporting requirements for small companies.

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

New GAAP and audit timeline



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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 chose for simplicity's sake 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. 2015 may sound like a long way off, but an opening balance sheet will be required from 2014 and early adoption is an option.

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

Stage	Time	What
Advance planning	2013	• What, in broad terms, will be the impact of the change? • Should the group be reorganised in response to issues such as, for example, tax arrangements, dividend streams or pension schemes? • Can the number of companies in the group be rationalised? • Will the change in GAAP create any major issues which require considerable time and effort? (e.g. computer systems, which are iXBRL compliant for tax filing purposes, reward packages, earn-outs)
Detailed planning	2013/14	• Arrange detailed training for project leaders. • Determine the choice of accounting framework available for each entity. • Identify key differences in accounting treatment. • Assess impacts on tax strategy and compliance. • Assess impact and opportunities in functional areas (e.g. treasury, human resources, investor relations, tax). • Engage with auditors to discuss the impact of the change in regime. • Evaluate the most appropriate regime for each entity and the group as a whole. • Communicate change to key stakeholders in the business. • Make systems enhancements.
Implementation	2014/15	• Prepare opening balance sheet. • 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, including a set of illustrative FRS 101 accounts 'Freeing up the GAAPs' which demonstrate the impact of moving from IFRSs to FRS 101, and a set of illustrative FRS 102 financial statements 'Finding the GAAPs', which demonstrate the impact of moving from UK GAAP to FRS 102. Your usual Deloitte contact would be happy to share these with you.

Useful links

Further resources and information about the services we offer can be found at www.deloitte.co.uk/futureofukgaap

The final standards can be found at www.frc.org.uk

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Designed and produced by The Creative Studio at Deloitte, London. 25033A