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The transition to 'new' UK GAAP
Key decisions to be made by 1 January 2014

In a nutshell
The date of transition to the new UK financial reporting regime is fast approaching. If your company's year-end is 31 December, you are likely to be among the first to move, with the first 'new UK GAAP' financial statements required for the year ending 31 December 2015. This means that the transition date – and therefore the date of the opening balance sheet under the new regime – is 1 January 2014.

Before this date, management will need to think about the transitional effects and make certain decisions affecting financial reporting, tax and wider business processes. This newsletter highlights some of the key issues that you may want to consider.

If hedging strategies are relevant for your business, you should consider whether you wish to apply hedge accounting in your company or group accounts before their date of transition.

Top pre-transition issues

1) Have you chosen your GAAP?
Whichever GAAP you choose (whether IFRSs as endorsed by the EU, FRS 101 *Reduced Disclosure Framework* or FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*), you will need to prepare an opening balance sheet accordingly. As some of the considerations below will follow from your choice of GAAP, it is sensible to make this decision by the transition date.

2) Do you need to designate hedge arrangements?
Under 'old' UK GAAP (unless you were applying FRS 26 *Financial Instruments: Recognition and Measurement*) there are no formal hedge accounting requirements and very limited guidance on how to account for derivatives. Whichever GAAP is selected, management will need to formally designate, document and test hedging relationships and bring derivatives onto the balance sheet as a separate asset or liability. This will be necessary for transactions such as the use of forward contracts to minimise FX exposure on foreign currency transactions and interest rate swaps to fix the interest rate on a floating rate bank loan.

Hedge relationships must be designated by the date of transition if hedge accounting is to be applied from that date.† Late designation of 'cash flow' hedge relationships may make assessment and measurement complex, both on designation and in future.

If hedging strategies are relevant for your business, you should consider whether you wish to apply hedge accounting in your company or group accounts before their date of transition.

More information on FRS 102 can be found in our 'Need to Know' available at www.ukaccountingplus.co.uk

† The Financial Reporting Council has **proposed amendments to the hedge accounting requirements of FRS 102** which will not be finalised until 2014. Relief may be provided for limited retrospective application of hedge accounting, but this has not yet been finalised. It would not be expected to apply to companies choosing to apply the recognition and measurement requirements of IAS 39 or IFRS 9 under the financial instrument accounting policy choice available in FRS 102.

3) Have you considered the tax effects?
Transition to a new GAAP may have a number of tax consequences. The timing or quantum of cash tax payments may be affected and additional compliance considerations may arise. For example, a move to IFRSs, FRS 101 or FRS 102 may result in new areas of tax legislation becoming relevant.

Various tax elections are available that could reduce the tax impact of transitioning to a new GAAP. In many cases there are time limits for making the election, which vary from election to election. For example, an election can be made to designate the currency of a UK resident investment company for tax computation purposes, which must be made before the beginning of an accounting period if it is desired that it should take effect for the whole period.

Where derivatives are recognised on balance sheet at fair value, any movement might be expected to be liable to tax. However, the effect is deferred unless the company elects derivatives. Thus is if a company does not wish to disregard the movements, but instead prefers to compute taxable income in line with the accounting treatment, it can elect to do so. You would need to make such an election before the start of the accounting period in which the company first starts to account for derivatives at fair value.

This is a complex area and early consideration of the relevant areas of tax legislation and consideration of any time limits for elections will help you to manage your business's tax compliance during the transition period efficiently.

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4) Is there a group defined benefit pension scheme?
Companies reporting under 'old' UK GAAP that were part of a larger group with a multi-employer pension scheme may have taken advantage of the exemption in FRS 17 *Retirement Benefits*, which enabled companies within the group to account for the scheme as if it were a defined contribution scheme, recognising only their contributions payable.

IFRSs, FRS 101 and FRS 102 remove the multi-employer exemption for schemes under common control. Groups will have the option either to a) account for the full defined benefit scheme in the employer that is legally responsible for the scheme, or b) to set up a stated policy or agreement to allocate the costs and associated deficit to group members.

A stated policy or agreement may be attractive as it reduces the distributable profits effect on the legally responsible employer. Any contractual agreement should be in place by the date of transition. You may also wish to take the opportunity to think now about whether any capital restructuring is required in order to mitigate any adverse impact on payment of dividends.

5) Are your systems ready to capture new GAAP information?
Whichever GAAP is selected (whether IFRSs, FRS 101 or FRS 102), you will need to have sufficient information to prepare an opening balance sheet in accordance with the requirements of the new framework and capture the necessary data going forward. Therefore you will need to check that your systems are set up to capture that information in time for the transition date.

Additionally, for a year from the transition date, you will need to capture two sets of financial information – that required to prepare 'old GAAP' financial statements to file for the end of that financial year (e.g. for the year ended 31 December 2014), and that required to prepare the comparatives for the following year under 'new GAAP'. It is important to consider whether this will require additional resource and plan early for any increase in workload.

Other early-stage issues to consider

6) Have you considered the impact on your dividend policy?
A change of GAAP is likely to affect retained earnings for most companies, and will therefore impact the level of profits available for distribution. In particular, some changes in accounting (such as financial instruments, deferred tax, goodwill and intangibles, foreign currency, pensions and investments) may have a significant impact on retained earnings.

If your business adopts IFRSs, FRS 101 or FRS 102 for the year ended 31 December 2015, it can make a distribution in the year ended 31 December 2014 without regard to the effect of the future change in accounting framework, as long as that distribution is both declared and paid before 1 January 2015. If the effect of changing GAAP is likely to reduce distributable profits, you may wish to bring forward plans to pay dividends.

7) Have you addressed the potential impact on loan covenants?
Existing loan agreements may contain covenants that are based on the most recent set of audited financial statements. Those covenants could be breached as a result of the change in GAAP. Transition to a new GAAP may impact net assets at the date of transition (if, for example, an additional deferred tax liability is recognised) or profit post-transition (for example, by requiring amortisation of assets previously given an indefinite useful life).

A practical solution may be to enter into discussions with lenders at an early stage to establish covenants that are based on a 'frozen GAAP' (for example, based on UK financial reporting standards in force as at 31 December 2013). This provides mutual certainty as to the meaning and application of particular covenants.

Further information

Deloitte has produced a number of publications including ukGAAP 2014 in your pocket – a guide to FRS 102', a useful pocket guide comparing FRS 102 to full IFRSs and existing UK GAAP, and 'Choosing your GAAP', which looks at the broader implications of changing accounting frameworks.

Both of these publications, together with other UK accounting, reporting and corporate governance news and publications, can be found at **www.ukaccountingplus.co.uk**.

If you would like further, more detailed information or advice, copies of the publications mentioned above or to discuss how these changes could affect your business, please contact your usual Deloitte partner or:

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