ACCA

technical factsheet 181

FRS 102 – making the transition to new UK GAAP

CONTENTS

1. INTRODUCTION

FRS 102 is a standard based on the IFRS for SMEs that will replace all the existing FRSs, UITF abstracts and SSAPs apart from the FRSSE and FRS 27.

FRS 102 results in a big change to the structure of UK GAAP and this factsheet includes an analysis of the changes to terminology and formats from current UK GAAP, of the adoption timeframe and transition provisions and a detailed comparison of topical areas between the current and the new UK GAAP framework, including analysis of the potential tax impact of the new accounting requirements.

2. TERMINOLOGY AND FORMAT OF ACCOUNTS

Section 3 of FRS 102 deals with financial statement presentation, and the scope of the section is to explain fair presentation of financial statements, what compliance with the FRS requires, and what a complete set of financial statements is.

The standard goes on to say *'Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses.'* The standard does allow additional disclosure where it is necessary to enable users to understand the accounts better, as is the case in existing UK GAAP.

Before looking at the format FRS 102 accounts will follow, it will be helpful to consider some of the changes of terminology in this area. Appendix 3 of FRS 102 sets out a table of terminology which is reproduced at the end of this section of the factsheet. Companies Act 2006 and associated legislation use the term 'balance sheet', but FRS 102 calls this document the 'statement of financial position'. A cash flow statement under FRS 102 has the very similar title of 'statement of cash flows'. The statement of total recognised gains and losses (STRGL) is called the 'statement of changes in equity' under the new regime.

The profit and loss account will be called the 'income statement' under the new two-statement approach, or the 'statement of comprehensive income' under the single statement approach, which would include the income statement and statement of changes in equity being presented as one statement. In effect, the single statement approach is the equivalent under UK GAAP of having the profit and loss accounts and statement of recognised gains and losses as one statement, while the two-statement approach would have them as two separate statements.

Example of a Statement of Comprehensive Income (single statement approach) follows:

	20X1	20X0
	£	£
Turnover	XXX	XXX
Cost of sales	XXX	XXX
Gross profit	XX	XX
Administrative expenses	XX	XX
Other operating income	(X)	(X)
Operating profit	XXX	XXX
Interest receivable and similar income	(XX)	(XX)
Interest payable and similar charges	X	X
Profit on ordinary activities before taxation	XX	XX
Taxation	(X)	(X)
Profit on ordinary activities after taxation and Profit for the financial year	XX	XX
Other comprehensive income		
Actuarial losses on defined benefit pension plan	(XX)	(XX)
Deferred tax movement relating to actuarial losses	X	X
Total comprehensive income for the year	XXX	XXX

A complete set of financial statements of an entity preparing its accounts under FRS 102 will include all of the above, together with the notes to the accounts. Although the terminology used in FRS 102 does differ somewhat from the familiar UK GAAP terms, paragraph 3.22 of FRS 102 does state that an entity may use titles for the financial statements other than those used in this FRS as long as they are not misleading. So there will be no problem if we continue to refer to the 'balance sheet' and 'profit and loss account'.

The standard makes it clear that the current legislation, Statutory Instrument 2008/410, relating to accounts formats, will remain the point of reference for the layout of the financial statements, and the formats of accounts will be largely similar under FRS 102 to current UK GAAP formats. There are, however, some disclosure requirements under FRS 102 that differ from those in current UK GAAP, and these are set out below:

- Debtors
  SI 2008/410 requires that on the face of the balance sheet *'the amount falling due after more than one year must be shown separately for each item included under debtors'.* FRS 102 states that this information will usually be disclosed in a note unless *'the amount of debtors due after more than one year is so material in the context of the total net current assets that in the absence of disclosure of the debtors due after more than one year on the face of the statement of financial position readers may misinterpret the financial statements',* in which case, disclosure should be on the face of the balance sheet.

- Creditors
  There is also a change in relation to creditors. SI 2008/410 states simply *'Amounts falling due within one year and after one year must be shown separately for each of these items and for the aggregate of all of these items'.* FRS 102 is more prescriptive and requires that *'an entity shall classify a creditor as due within one year when the entity does not have an unconditional right, at the end of the reporting period, to defer settlement of the creditor for at least twelve months after the reporting date'.* Under FRS 102, it is possible that more creditors will perhaps need to be disclosed as being due within one year because they cannot be shown as being due after more than one year unless the entity has an 'unconditional right' to defer settlement for at least a year.

- Capital and reserves
  There is some additional disclosure required by FRS 102 in relation to capital and reserves, and the standard allows for this to be presented either on the face of the balance sheet or by way of note. The standard requires a description of each reserve; and for each class of share capital the rights, preferences and restrictions attaching to that class including restrictions on dividends and repayment of capital must be disclosed. FRS 102 also requires details of shares in the entity held

by *'its subsidiaries, associates, or joint ventures'.* Although it should be noted that Companies Act 2006, section 136 prohibits a subsidiary from holding shares in its parent, unless the subsidiary is acting as personal representative or trustee, or as authorised dealer in securities.

- Planned major disposal
  FRS 102 also requires disclosure, as a note to the balance sheet if, at the reporting date, an entity has a binding sale agreement for a major disposal of assets, or a disposal group, that gives details of the facts and circumstances of the sale, a description of the asset and the carrying amount of the asset.

As already mentioned, FRS 102 has a slightly different approach to presentation of the entity's income, profits or losses, and this is set out in paragraph 5.2 of the standard:

'An entity shall present its total comprehensive income for a period either:

> *(a) in a single statement of comprehensive income, in which case the statement of comprehensive income presents all items of income and expense recognised in the period; or*
> *(b) in two statements—an income statement (which is referred to as the profit and loss account in the Act) and a statement of comprehensive income—in which case the income statement presents all items of income and expense recognised in the period except those that are recognised in total comprehensive income outside of profit or loss as permitted or required by this FRS.'*

A change from the single-statement approach to the two-statement approach, or vice versa, is a change in accounting policy.

If the single-statement approach is used, the entity shall present in its statement of comprehensive income the items set out in SI 2008/410 (schedule 1, 2 or 3 as appropriate) or in the LLP regulations, and, in addition, components of other comprehensive income recognised as part of total comprehensive income outside profit or loss as permitted or required by the FRS and its share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method.

Under the two-statement approach, an entity shall present in an income statement, the items to be included in a profit and loss account in accordance with SI 2008/410 (schedule 1, 2 or 3) or the LLP regulations. The statement of comprehensive income shall begin with profit or loss as its first line and shall display, as a minimum, line items that present components of other comprehensive income.

As a minimum, turnover must be presented on the face of the income statement (or statement of comprehensive income if presented), and also the post-tax profit or loss of discontinued operations. The appendix to section 5 of the FRS shows an example of the presentation of discontinued operations. FRS 102 does not require disclosure of 'operating profit'. However, if an entity elects to disclose the results of operating activities the entity should ensure that the amount disclosed is representative of activities that would normally be regarded as 'operating'.

Unless otherwise required under the relevant statutory instruments, an entity shall present an analysis of expenses using a classification based on either the nature of expenses or the function of expenses within the entity, whichever provides information that is reliable and more relevant.

The statement of changes in equity, which is the equivalent to the STRGL in current UK GAAP, presents an entity's profit or loss for a reporting period, other comprehensive income for the period, the effects of changes in accounting policies and corrections of material errors recognised in the period, and the amounts of investments by, and dividends and other distributions to, equity investors during the period.

The statement will show a reconciliation between opening and closing balances for each component of equity, disclosing changes arising from profit or loss, other comprehensive income, dividends and other movements relating to capital. The effects of prior period adjustments will also be disclosed here, as well as total comprehensive income attributable to owners of the parent and to non-controlling interests.

The notes to the accounts required by FRS 102 do not differ greatly from current requirements. The standard does set out the sequence that the notes should be presented in:

- a statement that the financial statements have been prepared in compliance with this FRS;
- a summary of significant accounting policies applied;
- supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented; and
- any other disclosures.

We have already seen how every primary statement required by the FRS has a different name under FRS 102, compared with existing UK GAAP. Many of the terms that we would normally use when describing items in the accounts are also referred to in different terms under the FRS. Appendix 3 sets out a table of terminology, reproduced below:

Company law terminology	**FRS 102 terminology**
Accounting reference date	Reporting date
Accounts	Financial statements
Associated undertaking	Associate
Balance sheet	Statement of financial position
Capital and reserves	Equity
Cash at bank and in hand	Cash
Debtors	Trade receivables
Diminution in value [of assets]	Impairment
Financial year	Reporting period
Group [accounts]	Consolidated [financial statements]
IAS	EU-adopted IFRS
Individual [accounts]	Individual [financial statements]
Interest payable and similar charges	Finance costs
Interest receivable and similar income	Finance income/Investment income
Minority interests	Non-controlling interest
Net realisable value [of any current asset]	Estimated selling price less costs to complete and sell
Parent undertaking	Parent
Profit and loss account	Income statement (under the two-statement approach) Part of the statement of comprehensive income (under the single- statement approach)
Related undertakings	Subsidiaries, associates and joint ventures
Stocks	Inventories
Subsidiary undertaking	Subsidiary
Tangible assets	Includes: Property, plant, equipment, investment property
Trade creditors	Trade payables

3. TRANSITION TO FRS 102

Paragraph 1.14 of FRS 102 sets out relevant implementation information. It is mandatory to apply the new standard to accounting periods beginning on or after 1 January 2015. Early application is permitted for periods ending on or after 31 December 2012. Entities whose accounts are prepared with reference to a SORP may only adopt FRS 102 early if this would not conflict with the SORP requirements.

Eligibility to apply FRS 102 is set out quite succinctly in FRS 100, paragraph 4:

'Financial statements (whether consolidated financial statements or individual financial statements) that are within the scope of this FRS, and that are not required by the IAS Regulation or other legislation or regulation to be prepared in accordance with EU-adopted IFRS, must be prepared in accordance with the following requirements:
(a) If the financial statements are those of an entity that is eligible to apply the FRSSE, they may be prepared in accordance with that standard;
(b) If the financial statements are those of an entity that is not eligible to apply the FRSSE, or of an entity that is eligible to apply the FRSSE but chooses not to do so, they must be prepared in accordance with FRS 102, EU-adopted IFRS or, if the financial statements are the individual financial statements of a qualifying entity,FRS 101.'

If an entity does not adopt the standard early, the accounts for the year ended 31 December 2015 will have to be prepared under FRS 102. However, the comparative figures for the year ended 31 December 2014 will also have to be prepared with reference to the standard, so the date of transition will be 1 January 2014 for all entities (with 31 December year ends) that do not adopt the standard early. As the standard makes clear: an entity's date of transition to the FRS is the beginning of the earliest period for which the entity presents full comparative information in accordance with this FRS in its first financial statements that comply with the FRS.

This will have an impact on the preparation of (assuming a 31 December year-end) the 2014 accounts, because they will be prepared under 'old GAAP', but will have to be restated under FRS 102 to provide comparatives for the 2015 accounts. This will almost certainly mean additional work in relation to the 2014 accounts, as, at the very least, it will be necessary to ensure that sufficient information is available about the 2014 figures to make restating in 2015 possible.

Section 35 of FRS 102 deals with the transition to the new GAAP, and it applies to all first time adopters, regardless of which GAAP was being followed previously. Paragraph 35.4 states: *'An entity's first financial statements that conform to this FRS are the first financial statements in which the entity makes an explicit and unreserved statement in those financial statements of compliance with this FRS.'*

On transition, there is a set process that needs to be followed. The entity should have an opening balance sheet, or statement of financial position as it is termed under FRS 102, that is as at the date of transition. There are four things that the entity needs to do in relation to that opening balance sheet:

- recognise all assets and liabilities whose recognition is required by the standard;
- not recognise assets and liabilities where the FRS does not permit such recognition;
- reclassify items previously recognised as one type of asset, liability or component of equity that are a different type of asset, liability or component of equity under FRS 102; and
- apply the provisions of FRS 102 in measuring all the recognised assets and liabilities.

If the change to FRS 102 results in a change in accounting policies, any adjustments arising will relate to transactions or events that occurred prior to the transition and so should be made directly in retained earnings at the date of transition. Section 4 of this factsheet looks at tax considerations in connection with transition and onward application of FRS 102.

The standard does state that if it is impracticable for an entity to make any of the adjustments required, the entity should make the adjustments in the earliest period for which it is practicable, and identify any items that are not comparable. If it is impracticable to provide any disclosures required for any period before the period that the first FRS 102 accounts are prepared, that omission should be disclosed.

The standard provides a list of transactions for which the accounting should not be retrospectively changed on first time adoption:

- derecognition of financial assets and liabilities
- hedge accounting
- accounting estimates
- discontinued operations, and
- measuring non-controlling interests.

Details of how FRS 102 requirements, in relation to the above areas, should be applied prospectively are set out in paragraph 35.9 of the standard. The standard does allow a certain amount of choice to the first time adopter. The areas where choices are available are set out in some detail in paragraph 35.10.

Section 35.12 of the standard states: 'An entity shall explain how the transition from its previous financial reporting framework to this FRS affected its reported financial position and financial performance.' If an entity has not previously presented financial statements for any previous periods, there should be a statement in the accounts that they are the first financial statements to conform to FRS 102.

If there have been financial statements previously under a different GAAP, the first to conform to FRS 102 should include a description of each change in accounting policy and a reconciliation of equity and the entity's profit or loss between the amounts determined by FRS 102 and those arising under the previous financial reporting framework.

Example reconciliation:

Reconciliation of equity	31/12/14	01/01/14
	£	£
Equity under previous GAAP	XXX	XXX
Adjustments:		
Accrued holiday pay	(X)	(X)
Goodwill amortisation	(X)	(X)
Equity under FRS 102 (as adjusted)	**XXX**	**XXX**

Reconciliation of profit or loss	
Profit for year under previous GAAP	XX
Holiday pay accrual	(X)
Goodwill amortisation	(X)
Profit for the year under FRS 102 (as adjusted)	**XX**

4. DETAILED COMPARISON OF TOPICAL AREAS BETWEEN CURRENT AND NEW UK GAAP

This section provides an analysis of the main changes to current UK GAAP by comparing requirements under current UK GAAP and FRS 102 in respect of topical areas where the introduction of FRS 102 is expected to produce the most significant impact.

As well as analysing the financial reporting implications of the changes brought about by FRS 102, this section offers a number of considerations in respect of commercial consequences, taxation implications and transition issues that are likely to be of relevance to a large number of entities in preparing for the application of FRS 102 or in evaluating early adoption of the new standard.

Intangibles and Goodwill – Measurement after Initial Recognition

Current UK GAAP	FRS 102
Intangibles other than goodwill may be revalued to their market value if they have a readily ascertainable market value, which may be established only if the asset belongs to a homogenous population of equivalent assets and an active market exists for that population of assets. FRS 10 presumes that the useful economic life of intangibles and goodwill would not exceed 20 years but the presumption may be rebutted if it is possible to justify a longer or indefinite useful economic life. Where they are regarded as having a limited useful economic life, they should be amortised systematically over their life. Where they are regarded as having an indefinite useful economic life they should not be amortised.	Intangibles other than goodwill may be measured after initial recognition using the cost model or revaluation model. Under the cost model assets are recognised at cost less accumulated amortisation and impairment losses. Under the revaluation model intangibles are measured at fair value at the date of revaluation less subsequent amortisation and impairment losses. Revaluation is only possible when fair value can be determined by reference to an active market for an intangible. Other intangibles and goodwill are considered to have a finite useful life and should be amortised systematically over their life. If it is not possible to make a reliable estimate of the useful life, it should be deemed not to exceed 5 years.

Reporting and commercial impact of the changes
The main impact on financial reporting will be in respect of intangibles and goodwill for which it is not possible to make a reliable estimate of their useful economic life, or which would have been regarded as having an indefinite useful life and not amortised under current UK GAAP. In such instances the assets will be amortised over a maximum period of 5 years on a straight-line basis. For material assets, such as goodwill acquired in a business combination, that may determine a significant amortisation charge hitting the profit or loss (statement of income) and therefore affecting the results of the entity and reducing its distributable profits.

Additionally a substantial amortisation charge arising after the acquisition of intangibles and goodwill is likely to impact on the operating profit margin and reserves of an entity and therefore may result in the breach of debt covenants, like PBIT-based interest cover, gearing and dividend cover.

The adverse effect on an entity's results is also likely to impact on any remuneration and share based payment schemes agreed with management and employees, therefore reducing the attractiveness of investing in intangibles and in business acquisitions involving substantial goodwill for which it is not possible to make a reliable useful economic life estimate.

It could be therefore necessary to renegotiate debt covenants or rewrite results driven remuneration agreements in order to take into account the possible effects of FRS 102 on investment or expansion plans involving intangibles and goodwill.

Transition
For an intangible asset that meets the recognition criteria and the criteria for revaluation in Section 18 of FRS 102, the first-time adopter has the choice of measuring it at its fair value on the transition date and using that value as deemed cost; or using a previous GAAP revaluation as deemed cost at the revaluation date.

Intangibles and goodwill not amortised under current UK GAAP, because regarded as having an indefinite useful economic life, shall not be amortised retrospectively but should start to be amortised, in accordance with FRS 102, prospectively on first-time adoption.

Taxation impact of the changes
One of the most significant changes to intangible assets and goodwill is the rate at which they will be amortised under FRS102. Currently UK GAAP presumes a maximum useful economic life of 20 years, rebuttable if it can be justified that there is a longer life, though in most circumstances this will be difficult to demonstrate.

The main presumption is that intangible assets and goodwill will always have a finite life if it is not possible to estimate the useful life. Businesses would therefore need to revisit if elections made would still be appropriate under the Intangible Assets Regime.

Provided that it meets the conditions, the amortisation of intangible fixed assets and goodwill in the company's accounts may be eligible for corporation tax relief under the corporate intangible asset regime under Corporation Tax Act (CTA) 2009, Part 8.

One of the main aspects of Part 8, CTA 2009 is that intangible fixed assets which are acquired for consideration may be amortised over their useful economic life and a corporation tax deduction claimed for the amortisation.

HMRC have yet to change their guidance to reflect the introduction of FRS102; in their manuals they state that 'in general it is expected that intangibles will have a useful life of no more than 20 years. A longer period is permitted only where the durability can be demonstrated.' It is also stated that a shorter period of amortisation may be used, if this reflects commercial reality. See:
http://www.hmrc.gov.uk/manuals/cirdmanual/cird30540.htm

Making the assumption that amortisation is allowable for corporation tax purposes, the shortening of amortisation period effectively accelerates the tax relief.

Goodwill and Other Intangibles – Recognition

Current UK GAAP	FRS 102
FRS 10 deals with both goodwill and intangible assets.	FRS 102 deals with goodwill and other intangible assets in separate sections of the standard. Goodwill is included in the section that deals with business combinations.
Purchased goodwill is defined as the difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities.	Goodwill is defined as future economic benefits arising from assets that are not capable of being individually identified and separately recognised. In particular goodwill is the excess of the cost of a business combination over the acquirer's interest in the net amount of the identifiable assets, liabilities and contingent liabilities recognised.
FRS 10 defines intangible assets as non-financial fixed assets that do not have a physical substance but are identifiable and are controlled by the entity through custody or legal rights. Identifiable assets, in line with companies legislation, are those that can be disposed of separately without disposing of a business of the entity. If an asset can only be disposed as part of a business, it is considered indistinguishable from that business's goodwill and accounted as such.	An intangible asset is defined as an identifiable non-monetary asset without physical substance. Such an asset is identifiable when: a) it is separable, ie it can be separated or divided from the entity and sold, transferred, licensed etc. either individually or together with a related contract or asset or liability; or b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
FRS 10 prohibits recognising an intangible asset if future benefits are expected to flow to the entity but the entity does not control the asset via legal rights or custody. That is the case, for example, for a portfolio of clients or a team of skilled staff, where it is expected that they will continue to request the firm's services or offer their services, but the entity has insufficient control over the expected future benefits to recognise an asset.	FRS 102 requires an intangible to be recognised only if: a) it is probable that the expected future economic benefits attributable to the asset will flow to the entity: and b) the cost or value of the asset can be measured reliably.
An intangible asset acquired as part of a business acquisition should be capitalised separately from goodwill if its value can be reliably measured on initial recognition. Otherwise the intangible asset should be subsumed within goodwill.	An intangible asset acquired in a business combination is normally recognised as an asset because its fair value can be measured with sufficient reliability.

Reporting and commercial impact of the changes
The definition of an intangible asset in FRS 102 allows the recognition of intangibles even if they cannot be disposed of separately, which, on the contrary, is a specific requirement under current UK GAAP. In such a case FRS 102 permits recognition if the asset arises from contractual or other legal rights. On the other hand, even if the entity does not have control of the asset via contractual or legal rights, an intangible may still be recognised under FRS 102 if it can be separately sold or transferred.

As FRS 102 also implies that the fair value of an intangible asset acquired in a business combination can normally be reliably measured, the new standards are likely to result in more intangibles being recognised. In particular that could be the case in business combinations where, under current UK GAAP, intangibles are rarely recognised separately from goodwill. The main impact on financial reporting may result in assets like customer relationships or order books acquired in a business combination to be recognised as identifiable intangibles under FRS 102, separate from goodwill and possibly amortised over different useful lives.

For example a company may acquire the business of another entity that specialises in developing and producing automated industrial machinery for quality control purposes and the purchase agreement may refer to a number of items being transferred like plant and machinery, fixtures, stock, registered intellectual property, know how, customers' and suppliers' lists, specifically skilled workforce, such as researchers and designers, and unregistered intellectual property. Under current UK GAAP a number of intangibles, such as customers' and suppliers' lists, skilled workforce and unregistered intellectual property would not normally be recognised. Under FRS 102 they are likely to be recognised as separate intangibles as a result of the business combination. That is because FRS 102 implies that in a business combination the fair value of an intangible can normally be reliably measured and that it is not necessary, as under current UK GAAP, for intangibles to be both separable and controlled via custody or legal rights at the same time to be recognised.

Recognising more intangible assets of different types, with different amortisation periods, could produce more precise results but also require increased and more complex financial reporting work. Additionally material differences in amortisation will impact the results of the reporting entity and its distributable profits. An entity should obtain a detailed understanding, under FRS 102, of the intangibles being acquired as part of a business combination to plan the impact of the proposed transaction on the entity's financial reporting.

Transition
For an intangible asset that meets the recognition criteria and the criteria for revaluation in Section 18 of FRS 102, the first-time adopter has the choice of measuring it at its fair value on the transition date and using that value as deemed cost; or using a previous GAAP revaluation as deemed cost at the revaluation date.

A first-time adopter of FRS 102 may elect not to apply the business combinations provisions to combinations effected before the date of transition. In such a case the entity shall recognise, reclassify and measure, as at the date of transition, all its assets and liabilities acquired or assumed in a past business combination in accordance with the various relevant provisions in FRS 102, apart from a few exceptions including:

- intangible assets other than goodwill, as intangible assets subsumed within goodwill shall not be separately recognised;
- goodwill, as no adjustment shall be made to the carrying value of goodwill.

Taxation impact of the changes
Recognition of intangible assets acquired in a business combination also represents a significant change under FRS 102. Currently, many intangible assets are commonly subsumed within goodwill as they are not separable. More intangible assets are likely to be recognised separately from goodwill under FRS102 than before.

For tax purposes goodwill is defined by referring to the definition for accounting purposes. HM Revenue & Customs describe goodwill as:
'"Goodwill", in accounting terms, is simply the difference between the price a business fetches when it changes hands, and the value of its identifiable (including intangible) assets. But goodwill that only appears in the consolidated accounts of a group of companies, and not in company-level accounts, is outside the scope of the CTA09 rules.'

Therefore a goodwill asset recognised under an accounting standard in the individual accounts of a company will be automatically recognised under the UK Corporation tax regime provided it was created or acquired on or after 1 April 2002.

FRS102 separates goodwill from other intangible assets and includes it in Business Combinations and Goodwill section. An intangible asset other than goodwill is defined by FRS102 as:

‘An intangible asset is an identifiable non-monetary asset without physical substance.
Such an asset is identifiable when:
(a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
(b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.’

HM Revenue & Customs describe intangible fixed assets including goodwill as:
‘The term “intangible asset” covers not only intellectual property, such as patents, copyrights, trademarks and know-how, but also a variety of other assets with commercial value such as agricultural quota, payment entitlements under the single payment scheme for farmers, franchises and telecommunication rights.’

For tax purposes Intangible assets including goodwill must satisfy two conditions:

- the asset conditions; and
- the FA02 rule.

The relevant legislation is included in Part 8 of the Corporation Taxes Act 2009.

To satisfy the asset conditions, the goodwill or an intangible fixed asset must be recognised as such in the company accounts, unless it falls under specific exclusions in legislation. To satisfy the FA02 rule, the company must have either created or acquired the asset directly or indirectly from an unrelated party on or after 1 April 2002.

The effect of changes to the business combination will increase the recognition of non-goodwill intangible assets. These assets will fall within the intangible assets regime under CTA 2009. The main feature of the intangible assets regime is that the tax treatment follows the accounting treatment. As there may be more assets classified as intangible assets the tax treatment will be easier to follow on from the accounts.

Patents
Patents are a specific type of intangible fixed asset; Finance Act 2012 introduced new legislation at Part 8A, Corporation Tax Act 2010, governing profits arising from the exploitation of patents, known as the Patent Box Regime.

The Patent Box Regime allows companies to apply a 10% rate of corporation tax to all profits attributable to qualifying patents (relevant profits), whether paid separately as royalties or embedded in the sales price of products. Qualifying income is likely to arise where:

- patented products are sold – that is sales of the patented product or products incorporating the patented invention or bespoke spare parts
- patent rights are licensed
- patent rights are sold.

The implementation of FRS102 will have little to no effect on patents as the recognition criteria for them are not materially different and, provided the patent has been recognised in the company accounts as an intangible, they fall within the intangible assets regime.

Software and Website Development Costs

Current UK GAAP	FRS 102
Under FRS 10 software development costs directly attributable to bringing a computer system or other computer-operated machinery into working condition for use within the business are classified as tangible fixed assets, like part of the hardware. UITF 29 applies the above principles in FRS 10 to website development costs (not website planning costs that cannot be capitalised) requiring that all such costs should be classified as tangible fixed assets.	FRS 102 does not address the classification of software and website costs and therefore each entity should develop and apply a suitable accounting policy to classify such costs as tangible fixed assets or as intangible assets. In developing a suitable accounting policy management makes reference to, in descending order, other FRS dealing with similar issues, any SORP applicable to the entity, general recognition criteria and measurement concepts in section 2 of FRS 102 and IFRSs. Software and website development costs (not research costs) may be recognised as internally generated intangibles only if the entity can demonstrate: a) the technical feasibility of completing the intangible asset so that it will be available for use or sale. b) its intention to complete the intangible asset and use or sell it. c) its ability to use or sell the intangible asset. d) how the intangible asset will generate probable future economic benefits. e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset. f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Reporting and commercial impact of the changes
In view of the lack of direction in FRS 102 it is conceivable that some entities will classify software and website development costs as intangible assets whilst under current UK GAAP they would have been classified as tangible assets. It is unlikely that choosing to classify assets under one or the other of the two categories will result in material differences in terms of initially recognised amount and subsequent amortisation/depreciation or impairment, especially in view of the fact that the estimated useful economic life of such assets is likely to be short.

Transition
Whether software and website development costs are treated as intangible or tangible assets, the deemed cost can be either the fair value on transition date, or a previous GAAP revaluation at the revaluation date.

Additionally the general transitional procedures in FRS 102 require the reclassification at the date of transition of items that were recognised under previous GAAP as one type of asset (ie tangible or intangible) or liability but are a different type of asset or liability under FRS 102.

Taxation impact of the changes
We have already seen what FRS 10 has to say about software. Under the current rules of FRS 10, internally generated assets cannot be capitalised, unless there is a readily ascertainable market value, which in practice would be rarely, if ever. But internally generated software is excluded from this general

rule, which makes it clear that such costs, if appropriate, should be capitalised and treated as a tangible fixed asset.

Under FRS102, there will be greater scrutiny of Intangible assets, certain software costs will be reclassified from Tangible fixed assets to intangible fixed assets, leading to possibly acceleration of tax relief through accounting amortisation of these software that will fall within the intangibles assets regime instead of the capital allowances regime.

The tax treatment mirrors the tax position for website costs, and guidance can be found here: http://www.hmrc.gov.uk/manuals/bimmanual/bim35810.htm

The main feature of the intangible assets regime is that the tax treatment follows the accounting treatment. As there may be more assets classed as intangible fixed assets the tax treatment will be easier to follow on from the accounts.

As the choice may be down to the individual entity, the tax difference will be down to how far the policy of the entity differs from its current accounting policy. In addition, there is also the possibility of recognising software and website development as an internally generated intangible fixed asset, subject to various conditions.

Due to the lack of guidance, the change in tax treatment could be significant as the difference between the current fixed asset treatment and the possible intangible asset treatment under FRS102.

Leases – Classification and Incentives

Current UK GAAP	FRS 102
SSAP 21 classifies leases as finance leases and operating leases. A finance lease is a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee. SSAP 21 includes a presumption that if the present value of the minimum lease payments amounts to 90 per cent or more of the fair value of the leased assets, the lease is a finance lease. An operating lease is a lease other than a finance lease.	Under FRS 102 a lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership. FRS 102 does not include a presumption for the classification of a finance lease based on the present value of the minimum lease payments but indicates that the classification of a lease depends on the substance of the transaction rather than the form of the contract. FRS 102 also includes examples of situations in which a lease would be normally classified as a finance lease; such as: a) the lease transfers ownership of the asset to the lessee by the end of the lease term; b) the lessee has an option to purchase the asset at a price sufficiently lower than fair value at the date the option becomes exercisable that it will be reasonably certain at the inception of the lease that the option will be exercised; c) the lease is for the major part of the asset's economic life even if the title is not transferred; d) at the inception of the lease, the present value of the minimum lease payments

	amounts to at least substantially all of the fair value of the leased asset (in this example there is no mention of the 90 per cent threshold); and e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications. Further indicators of situations that could result in a lease being classified as a finance lease are: a) lessor's losses associated with the cancellation of the lease are borne by the lessee; b) gains or losses from the fluctuation of the residual value of the leased asset accrue to the lessee; and c) the lessee has the ability to continue to lease the asset for a secondary period for a rent substantially lower than market rent.
UITF Abstract 28 states that all incentives for the agreement of a new or renewed operating lease should be recognised as an integral part of the net payment agreed for the use of the leased asset. Lease incentives, like rent-free periods or cash inducements, are allocated on a straight line basis over the shorter of the lease term and the period to the first rent review, ie the time when the prevailing market rent will be payable.	Under FRS 102 lease incentives are recognised on a straight line basis over the lease term. The incentives cannot be recognised over a shorter period to the first rent review.

Reporting and commercial impact of the changes
The absence in FRS 102 of a presumption for the classification of a finance lease based on the present value of the minimum lease payments, the 90 per cent of fair value threshold under current UK GAAP, is likely to result in a different classification of some leases under the new FRS. For example, leases exceeding 90 per cent of the asset's fair value may be more easily classified as operating leases if they effectively do not transfer all the risks and rewards of ownership. Conversely, leases whose present value of payments does not approach 90 per cent of fair value may be classified as finance leases by looking at the substance of the contract.

The financial reporting impact of recognising a lease as an operating lease rather than as a finance lease is well known. For a lessee an operating lease results in a constant expense in the profit or loss over the term of the lease with little or no effect on the financial position of the entity, while a finance lease results in the immediate recognition of the fair value of the leased asset and a corresponding liability that may have a material effect on the financial position of the entity. In terms of financial results the difference between classifying a lease as an operating lease or a finance lease is unlikely to be very material; the rental expenses in the profit or loss for an operating lease will be constant while a finance lease will result in a depreciation charge of the capitalised leased asset and a finance charge which will be higher at the beginning of the lease term. However, the impact on the financial position of a lessee in classifying a lease as a financial lease is mainly derived by the liability, equal to the fair value of the leased asset, recognised at the commencement of the lease term.

In respect of a substantial asset capitalised under a finance lease the corresponding liability recognised is likely to increase the entity's gearing ratio and therefore may result in the breach of debt covenants. A capitalised leased asset may also result in the potential breach of non-financial debt covenants that may restrict capital expenditure beyond certain limits without approval.

Additionally under FRS 102 operating lease incentives are spread over the lease term rather than over the shorter period to the first rent review, meaning that the benefits to the lessee or the costs to the lessor may be amortised over a significantly longer period diluting their effects on the entity's expenses or income. The treatment of incentives under FRS 102 may therefore have a material effect to the financial results of an entity, potentially increasing the lease costs of a lessee and the lease income of a lessor.

Transition
A first time adopter is not required to follow the FRS 102 requirements in relation to lease incentives if the term of the lease commenced before the transition date, but may continue to recognise any costs or residual benefits on the same basis as before the transition.

When determining whether an arrangement contains a lease, a first time adopter may elect to consider facts and circumstances on transition date rather than when the arrangement was entered into.

Additionally, in accordance with the general transitional procedures in FRS 102, a lease that would be classified differently under FRS 102 (either as a finance or operating lease) should be reclassified as at the date of transition and the related assets and liabilities should be recognised and measured at that date in accordance with FRS 102.

Taxation impact of the changes
Finance lease
HMRC guidance in respect of finance leases is still applicable for companies using FRS 102. The guidance can be found on: http://www.hmrc.gov.uk/manuals/bimmanual/BIM61100.htm

For a finance lease, if the proper accounting treatment has been applied in a lessee's accounts, no adjustments will normally be necessary in the tax computation as correctly prepared accounts normally give the right treatment for tax purposes without further adjustments in the tax computation.
The charge for depreciation of the leased asset must not be added back in the lessee's tax computation (it does not relate to capital expenditure by the lessee) nor must the lessee's profit or loss on sale of the leased asset be adjusted in the tax computation.

The total of the depreciation charged in respect of the leased asset, adjusted for any profit or loss on sale, is equal to the total rentals paid less the finance charge element (charged against profits separately) and adjusted for rebates (or sometimes additional rental payments) on termination of the lease.

Operating lease incentive
Lease incentive can be agreements such as an up-front cash payment, the reimbursement of costs associated with a pre-existing lease commitment of the lessee, relocation costs, leasehold improvements or even a rent-free period.

Under current UK GAAP the lessor recognises the aggregate cost of incentives as a reduction of rental income over the lease term or a shorter period ending on a date from which it is expected the prevailing market rental to be payable. The allocation is on a straight-line basis unless another systematic basis is more appropriate.

The lessee recognises the aggregate benefit of incentives as a reduction of rental expense over the shorter of the lease term and a period ending on a date from which it is expected the prevailing market rental will be payable. The allocation is on a straight-line basis unless another systematic basis is more appropriate.

Under FRS 102 the lessor shall recognise the aggregate cost of the incentives as a reduction to income over the lease term on a straight-line basis, unless another systematic basis is more appropriate. The lessee shall recognise the aggregate benefit of incentives as a reduction to rental expense over the lease term, unless another systematic basis is more appropriate.

Therefore under old UK GAAP, typically lease incentives would have been spread over a shorter period compared to the new FRS 102 requirements. There would be a tax cash flow implication in transitioning from a shorter to a longer period of recognising the benefit in the accounts.

HMRC guidance in respect of leases is given in the Business Lease Manual and can be found on: http://www.hmrc.gov.uk/manuals/blmmanual/BLM10005.htm.

Foreign Currency Translation

Current UK GAAP	FRS 102
SSAP 20 (applicable to entities not required or opting to apply FRS 23) requires foreign currency transactions to be translated in the entity's local currency using the spot exchange rate, or an average rate for a period that is a close approximation.	FRS 102 requires entities to initially translate foreign currency transactions in an entity's functional currency using the spot exchange rate, although an average rate for a week or month may be used if the exchange rate does not fluctuate significantly.
Foreign currency monetary items are retranslated at balance sheet date exchange rate. Non-monetary items are carried at historic exchange rate.	Foreign currency monetary items are subsequently translated in the functional currency at the exchange rate applicable at the end of the reporting period. Non-monetary items are carried at the historic rate and non-monetary items measured at fair value are translated at the rate of the date when the fair value is re-measured.
An entity's local currency is the currency of the primary economic environment in which the entity operates and generates cash flows.	An entity's functional currency is the currency of the primary economic environment in which the entity operates, normally the one in which it primarily generates and expends cash.
Exchange gains and losses are recognised in profit or loss.	Exchange differences on monetary items are recognised in profit or loss. Exchange gains or losses on non-monetary items measured at fair value are recognised as part of the change in fair value posted in other comprehensive income or profit or loss.
SSAP 20 also states that where a trading transaction is covered by a related or matching forward contract, the rate of exchange specified in that contract may be used.	FRS 102 does not include provisions about using a contracted exchange rate to match a trading transaction. Therefore balances covered by a forward contract will be retranslated at the year-end rate. In turn under FRS 102 a foreign exchange forward contract will be recognised in the balance sheet as a financial instrument at fair value through profit or loss. However, FRS 102 allows designating a foreign exchange forward contract as a hedging instrument in a designated relationship to hedge the foreign exchange risk of a trading transaction. In such a case the change in the fair value of the forward contract will be recognised in other comprehensive income to the extent that it effectively offsets the retranslation gain or loss on the expected cash flows from the trading transaction. The option of adopting hedge accounting is, however, onerous in terms of documentation, complexity of the rules and disclosures and it is unlikely to be attractive for many entities.
SSAP 20 only allows/requires foreign transactions and operations to be translated in the entity's local currency.	FRS 102 allows an entity to present its financial statements in any currency, a 'presentation currency'. To do so the all the items expressed in

	its functional currency should be translated in the presentation currency of choice. Assets and liabilities should be translated at the closing rate at the end of the reporting period while income and expenses shall be translated at the exchange rates at the day of transactions. Exchange differences resulting from the translation of financial statements in functional currency to presentation currency are recognised in other comprehensive income.

Reporting and commercial impact of the changes
The possibility of presenting financial statements in a currency of choice (a presentation currency) may have significant consequences for certain UK entities. While the translation into a presentation currency different from an entity's functional currency follows a set of separate rules whose effect on the financial statements are difficult to gauge, the use of a presentation currency may be important to a number of entities which, for example, need to provide comparable financial information to overseas shareholders or, as it is often the case for UK subsidiaries of a foreign group that may have Sterling as functional currency while their group prepares accounts in US Dollars or Euros, need to present their financial statements in the functional currency of their parent to facilitate consolidation procedures and comparability of results and financial position.

The use of a presentation currency that is not the same as the functional currency of an entity may result in a number of commercial consequences. In particular switching to financial statements presented in a currency other than Sterling may need to be agreed with lenders and would need to be verified against any restrictive covenants. Additionally choosing a foreign presentation currency may result in alterations to results reported into an entity's functional currency generated by the variations in exchange rates between the two currencies. Such variations may affect not only debt covenants but also remuneration and share based schemes that may have been originally stipulated by reference to local currency and that would need to be revisited to take into account any foreign exchange distortion.

For entities using forward foreign exchange contracts to match their commercial transactions, the changes in FRS 102 result in a more exacting financial reporting treatment. Such entities would have, under SSAP 20, reduced their exposure to volatility in the profit and loss account by using the exchange rates specified in the forward contracts. Under FRS 102, in order to achieve an element of matching foreign exchange gains and losses on their commercial transactions, entities may choose to apply hedge accounting to such arrangements in accordance with Section 12 of the standard. However, it is likely that entities may decide not to adopt hedge accounting because the administrative burden of maintaining the relevant documentation and the intrinsic complexities of hedge accounting may outweigh the benefits of the accounting treatment permitted.

Entities not opting to apply hedge accounting will, however, need to recognise forward foreign exchange contracts at fair value when they are taken out and will recognise fair value gains and losses in profit or loss on an on-going basis at each reporting date rather than just at the time of settlement. On the other hand, transactions and monetary items covered by forward contracts will be translated at the exchange rate of the transaction date and of the year end respectively with exchange differences recognised in profit or loss. Effectively this treatment will produce two sets of entries in profit or loss, while under SSAP 20 there would have been none.

An example may illustrate the accounting treatment of forward contracts under FRS 102 for an entity not applying hedge accounting:

On 31 January 2016 a UK company sells cocoa to a Belgian company for €200,000 payable in three months; on the same day the UK company enters into a currency forward contract to sell €200,000 at the exchange rate of €1.15:£, settled on 30 April. The forward contract effectively locks in the value of the Euros to be received at the rate of €1.15:£. On 31 January, the fair value of the forward contract is zero, as the contract was concluded at market price.

At the company's year-end on 31 March 2016, the Euro had strengthened against Sterling and the fair value of the forward contract had become negative as a consequence. FRS 102 requires the change in fair value to be recognised in profit or loss.

On 30 April 2016 the Euro had continued to strengthen against Sterling and the fair value of the forward contract had fallen further. On the same date the UK company receives payment for the sale from the Belgian company and settles the currency forward contract.

The accounting entries are:

<u>31 January 2016</u>

	£	£
Dr Receivables	173,913	
Cr Sales		173,913

To recognise the sale of €200,000 at the spot rate of 1.15. The spot rate is assumed to be identical to the 90 days forward rate and the fair value of the forward is assumed to be zero at inception.

<u>31 March 2016</u>

	£	£
Dr Receivables	1,525	
Cr Foreign exchange (statement of income)		1,525

To record the exchange gain on the receivable of €200,000 translated at the year-end rate of 1.14. Carrying amount of the receivable 173,913+1,525= 175,438.

	£	£
Dr Change in Fair Value (statement of income)	1,525	
Cr Forward		1,525

To recognise the forward contract at fair value following appreciation of the Euro to 1.14.

<u>30 April 2016</u>

	£	£
Dr Cash	176,991	
Cr Receivables (173,913+1,525)		175,438
CrForeign exchange (statement of income)	1,553	

To record the receipt of €200,000 at the spot rate of 1.13, the settlement of the receivable and the connected foreign exchange gain.

	£	£
Dr Change in Fair Value (statement of income)	1,553	
Cr Forward		1,553

To recognise the change in the fair value of the forward contract following appreciation of the Euro to 1.13. Negative carrying value of the forward is 1,525+1,553= 3,078

	£	£
Dr Forward	3,078	
Cr Cash		3,078

To record the cash paid to settle the forward contract at the rate of 1.15. Cash amount after settlement 176,991-3,078=173,913.

The net effect of the forward contract is that of locking in the cash receivable on the sale at £173,913 (€200,000/1.15) notwithstanding the changes in exchange rates reflected in the translation of receivables and in the fair value of the contract.

Transition
The transition section of the standard is silent on the treatment of foreign currency translations and accordingly the general transitional procedures in FRS 102 will apply on first-time adoption, ie assets and liabilities will be recognised, reclassified and measured as at the transition date in accordance with FRS 102.

Taxation impact of the changes
Profits and losses arising to the company from its derivative and related contracts include exchange gains and losses. The exception to this is a gain or loss on a derivative that consists wholly or mainly of currency. Where a company prepares its accounts in accordance with UK GAAP (excluding FRS23 and 26) and uses a forward currency contract to match its exchange exposure, the exchange movements arising in respect of the forward currency contract that are eligible for matching are determined by reference to the spot rate prevailing at the end of the accounting period. It is no longer possible for profits and losses on forward currency contracts to be left out of account.

The effect on the company in the example will be that the loss on the forward currency contract (£1,525) will be recognised at the end of the company's accounting period, whereas the sales debtor contract will be unaffected.

At the end of April, when the debt is repaid, there will be a further loss of £1,553 on the currency contract. The effect is to accelerate recognition of the loss and distort the balance sheet.

Investment Properties

Current UK GAAP	FRS 102
Under SSAP 19, investment properties are required to be included on the balance sheet at open market value and are not subject to depreciation. The changes in value should not be taken to profit and loss account but to the statement of recognised gains and losses (and credited to a revaluation reserve) unless a deficit is expected to be permanent in which case it does go to the profit and loss account. Valuation does not need to be by a qualified or independent valuer, but disclosure is required of the names or qualifications of the valuers, the bases used and whether the valuer is an employee or officer of the company. Investment properties are defined as 'held not for consumption in the business operations but as investments, the disposal of which would not materially affect any manufacturing or trading operations of the enterprise'.	FRS 102 requires valuation at fair value, *only if* the property can be measured reliably without undue cost or effort. If that is not possible, the property should be accounted for as 'property, plant and equipment', and not as investment property. If the investment property fair value can be measured reliably, it shall be measured at fair value at each reporting date with changes in fair value recognised in profit or loss. Disclosure is required of the extent to which the fair value of investment property is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the investment property being valued. If there has been no such valuation, that fact shall be disclosed. Investment properties are defined as those 'held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes; or sale in the ordinary course of business'.

Reporting and commercial impact of the changes
The main impact on financial reporting will be any upward revaluation going through the profit and loss account. If material amounts hit the profit or loss (statement of income), there will be an effect on the results of the entity, increasing its retained earnings. Gains on revaluation of investment properties, although included in retained earnings, would not be considered as distributable profits, as they are not

realised, and therefore entities should keep track of such gains and consider them separately when making a distribution.

Additionally, where the properties are not revalued and the property is categorised as property, plant and equipment, an additional amount of depreciation will go through profit and loss account and could impact on the operating profit margin and reserves of an entity and therefore may result in the breach of debt covenants, like PBIT-based interest cover, gearing and dividend cover.

Transition
On first adopting FRS 102 the entity may elect to measure an investment property at its fair value at transition date, using that value as its deemed cost, or it can elect to use a previous GAAP revaluation as its deemed cost at the revaluation date.

Taxation impact of the changes
Under FRS 102, investment property whose fair value can be reliably measured without undue cost or effort must be measured at that fair value at each balance sheet date with gains and losses recognised in profit and loss.

These gains or losses will be capital in nature and hence ignored for tax purposes. HMRC has yet to change their policy to include specific guidance with regard of gains and losses on investment properties. As a general rule, capital expenditure is not allowable unless there is a specific statutory allowance http://www.hmrc.gov.uk/manuals/bimmanual/BIM35105.htm.

So there would be no tax cash flow advantage for a debit to profit and loss and no tax cash flow disadvantage for a credit to the profit and loss as both amounts would be added /deducted for tax purposes.

Employee Benefits

Current UK GAAP	FRS 102
Disclosure of 'employee benefits' is not covered by a current UK standard. Companies Act 2006, section 411 requires certain information regarding staff numbers and costs, though this disclosure is NOT required of entities within the small companies' regime. The costs to be disclosed are wages and salaries paid or payable, social security costs incurred and other pension costs incurred. There is no explicit guidance in UK GAAP relating to other employee benefits, such as paid annual leave or paid sick leave. (Though it is mentioned obliquely in paragraph 11(b) of FRS 12.)	Section 28 of the standard deals with employee benefits, defined as 'all forms of consideration given by an entity in exchange for service rendered by employees, including directors and management'. The cost of accumulating compensated absences is required to be measured and recognised in the financial statements. Therefore an entity that has employees that have untaken holidays at the balance sheet date that will be paid for in the next financial year will need to make an accrual for such entitlements

Reporting and commercial impact of the changes
The main impact on financial reporting, which will only impact on those entities that did not previously include an accrual for holiday pay, will be increased employee costs hitting the profit or loss (statement of income) and therefore affecting the results of the entity and reducing its distributable profits. It is difficult to gauge how material the effect could be, and will of course vary depending on the number of employees, the size of their holiday entitlement and the timing of the entity's year end in relation to the holiday season.

Additionally there will be an increase in creditors due within one year; this is where the standard stipulates that the entity shall present the amount accumulated at the year end.

The calculation of accumulating compensated absences represents additional work for the entity, as there was no previous requirement to disclose this information, so most entities would not formerly have collated the information.

However, an advantage to this is that there will be a more uniform approach to this issue going forward, meaning that accounts will be more comparable in future. 'Old' GAAP was fairly unclear, so previously some entities did provide for accrued holiday pay and some didn't; and for those that did, many differing methods may have been used.

Transition
The transition section of the standard is silent on the treatment of employee benefits and accordingly the general transitional procedures in FRS 102 will apply on first-time adoption, ie assets and liabilities will be recognised, reclassified and measured as at the transition date in accordance with FRS 102 (resulting in an accrual for untaken holiday pay to be included as at that date).

Taxation impact of the changes
The changes will have a minimal effect for corporation tax purposes. A likely scenario for those companies who have not previously accrued for holiday entitlement at the year-end is that their staff costs will increase in the year of transition, leading to a reduction in its corporation tax liability for the transitional year.

Corporation Tax 2009, s1288 requires that any employee's remuneration, including directors' bonuses, accrued for in the accounts will be disallowed for corporation tax purposes unless paid within nine months of the year-end. Similar provisions exist for unincorporated businesses at Income Tax (Trading and Other Income) Act 2005, s36.

Basic Financial Instruments – recognition and measurement

Current UK GAAP	FRS 102
For entities not required or opting to apply FRS 26, UK GAAP includes limited requirements in respect of recognition and measurement of financial instruments. FRS 4 deals with recognition and measurement of financial instruments presented as debt in accordance with FRS 25 (for example loans received, bonds issued, certain types of preference shares etc.). FRS 25 deals with the presentation of financial instruments, notably with the classification of financial instruments as financial assets, financial liabilities or equity instruments. No standard under UK GAAP deals with financial assets such as current or fixed asset investments in shares or bonds, loans made and receivables. The Accounting Regulations (S.I. 2008/410) include measurement provisions in respect of fixed and current asset investments (such as listed and unlisted securities and long-term loans) but do not include specific provisions for other financial assets not classified as investments (like receivables). Under UK GAAP the accounting treatment of financial instruments not covered by standards or statute is therefore determined by prevailing	FRS 102 includes separate accounting requirements, outlined in two different sections of the standard, for 'basic' and 'other', more complex, financial instruments and transactions. The requirements for basic financial assets and liabilities are relevant to all entities. If an entity only enters into basic financial instrument transactions it will not need to apply the section of the standard that deals with more complex financial instruments. FRS 102 also allows an entity to apply the recognition and measurement provisions of IAS 39 or IFRS 9 to all its financial instruments rather than the corresponding provisions in the standard. Basic financial instruments include: a) cash and bank accounts b) trade and other accounts receivables and payables c) loans from banks or other third parties d) loans to and from subsidiaries and associates or to other third parties e) bonds and similar debt instruments f) investments in non-convertible preference shares and in non-puttable ordinary and preference shares g) commitments to receive or make a loan to another entity that cannot be settled net in cash.

practice.	Examples of more complex financial instruments include: a) options and forward contracts b) interest rate swaps c) investments in convertible debt and convertible preference shares d) investments in another's entity equity instruments other than non-puttable ordinary and preference shares e) rights, warrants and futures contracts.
	Basic financial instruments are required to be measured in different ways depending on the type and characteristics of the instruments:
FRS 4 requires debt (liabilities) to be initially recognised at the value of the proceeds received less the costs directly incurred to raise the debt. The finance costs of the debt, i.e. total payments to be made less net proceeds, is then allocated over the term of the debt at a constant rate over the carrying amount. In turn the carrying amount is increased by the finance costs for each reporting period and reduced by payments made in that period.	a) Debt instruments such as bonds, loans etc. will be measured initially at transaction price and subsequently at amortised cost using the effective interest method. b) Debt instruments that are payable or receivable within one year, typically trade payables or receivables, will be measured, initially and subsequently, at the undiscounted amount of the cash or other consideration expected to be paid or received. However, if the arrangement constitutes a financing transaction, ie the payment of a trade debt deferred beyond normal business terms or financed at a rate of interest that is not a market rate or in case of an outright short-term loan not at market rate, the financial asset or liability will be measured, initially and subsequently, at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. c) Debt instruments may also be designated by entity to be measured at fair value through profit or loss in certain specific circumstances.
Under the Accounting Regulations, investments should be carried at historic cost less diminution in value. Investments may also be measured in accordance with the alternative accounting rules, which involve taking revaluation surpluses to a revaluation reserve and not through the profit and loss.	d) Investments in non-convertible preference shares and in non-puttable ordinary and preference shares should be measured: i. at fair value with changes recognised in profit or loss if the shares are publicly traded or their fair value can otherwise be measured reliably ii. at cost less impairment for all other investments.
The Accounting Regulations also allows investments, and other financial instruments including derivatives, to be carried at fair value with changes in value going through the profit and loss account. However, entities taking this option are required to apply FRS 26.	Financial assets that are measured at cost or amortised cost shall be assessed for impairment at the end of each reporting period.

Some complex financial instruments, such as derivatives, are not recognised under current UK GAAP if an entity is not applying FRS 26 but would only require disclosures in certain circumstances.	Other complex financial instruments are required to be measured at fair value with changes in fair value recognised in profit or loss except for: a) investments in equity instruments that are not publicly traded and whose fair value may not be reliably estimated which shall be measured at cost less impairment and b) hedging instruments for which the entity is applying the hedge accounting provisions in FRS 102.

Reporting and commercial impact of the changes
The changes introduced by FRS 102 have a major impact on the accounting treatment of financial assets. In particular some debt instruments, such as bonds and loans, could have been carried at historic cost or valuation under current UK GAAP, while FRS 102 includes a specific requirement to measure them at amortised cost using the effective interest method, which represents the present value of the future cash flows of the financial asset discounted to the carrying amount of the financial asset using the interest rate that exactly produces such a result, ie the effective interest rate. The effective interest rate is determined by discounting expected cash flows, like interest payments, fees, finance charges, premiums, discounts etc., to the carrying amount of the financial asset initially recognised, ie the transaction price of the asset.

FRS 102 specifies the accounting treatment of debt instruments, both assets and liabilities, required to be settled within one year, which should be measured at the undiscounted amount of the cash or other consideration expected to be paid or received, unless they constitute a financing transaction. A financing transaction is typically one that does not include a stated interest rate or includes one that is not a market rate, such an interest-free loan or a trade debt payable beyond normal business terms. Debt instruments in respect of such transactions should be measured, if materially different from undiscounted amounts, at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. Current UK GAAP do not include such precise provisions for short-term financial assets and liabilities and these measurement requirements are likely to have a significant financial reporting impact.

In practice, under FRS 102, for goods or services sold to a customer on short-term credit a receivable is recognised at the undiscounted amount of cash receivable, normally the invoice price. The same applies to a purchase on short-term credit where a payable is recognised at its undiscounted invoice amount. The requirements for financing transactions apply equally to debt instruments that are to be settled within or beyond one year. Therefore if an item is sold on a one-year or a two-years interest-free credit, a receivable should be recognised at the present value of the cash receivable, for which the cash sale price of the item may be used as a close approximation. If, however, the cash sale price is not known, the cash receivable should be discounted using the prevailing market rate of interest for a similar receivable.

Examples of financing transactions may help clarify the accounting treatment:

Example 1

On 1 January 2015 an entity sells goods to a customer for £ 10,000 on a two-year interest free credit. The cash sale price of the goods is unknown. The prevailing interest rate of similar consumer finance transactions is 8%. The interest free sale constitutes a financing transaction under FRS 102 and the financial asset needs to be included at the present value of the future payments discounted using the market interest rate. The accounting entries are:

1) Initial recognition at 1 January 2015

	£	£
Dr Receivable	8,573.39	
Cr Sales		8,573.39

The carrying amount of the receivable is the present value of future payments discounted at the rate of 8%: 10,000/ (1.08)^2

2) Measurement 31 December 2015

	£	£
Dr Receivable	685.87	
Cr Profit or loss (interest)		685.87

Representing the unravelling of the interest on the financing transaction at the end of the reporting period. The carrying amount of the receivable is 8,573.39+685.87=9,259.26 (10,000/1.08)

3) Measurement at 31 December 2016

	£	£
Dr Receivable	740.74	
Cr Profit or loss (interest)		740.74

Representing the unravelling of the interest on the financing transaction at the end of the reporting period. The carrying amount of the receivable is 9,259.26+740.74=10,000 whilst the interest recognised is 685.87+740.74=1,426.61.

Example 2:

On 1 January 2015 an entity provides a £10,000 two-year interest free loan to one of its directors. The prevailing interest rate available on the market for a similar unsecured loan is 8%.
The loan is a financing transaction under FRS 102 and the financial asset needs to be included at the present value of the future payments discounted using the market interest rate. The accounting entries are:

1) Initial recognition at 1 January 2015

	£	£
Dr Receivable	8,573.39	
Dr Profit or loss (interest)	1,426.61	
Cr Cash		10,000

The carrying amount of the loan is the present value of future payments discounted at the rate of 8%: 10,000/ (1.08)^2

2) Measurement 31 December 2015

	£	£
Dr Receivable	685.87	
Cr Profit or loss (interest)		685.87

Representing the unravelling of the interest on the loan at the end of the reporting period. The carrying amount of the loan is 8,573.39+685.87=9,259.26 (10,000/1.08)

3) Measurement at 31 December 2016

	£	£
Dr Receivable	740.74	
Cr Profit or loss (interest)		740.74

Representing the unravelling of the interest on the loan at the end of the reporting period. The carrying amount of the loan is 9,259.26+740.74=10,000 whilst the interest recognised is 685.87+740.74=1,426.61.

Another significant difference introduced by FRS 102 is in respect of investments in shares. Under current UK GAAP such investments are normally carried at historic cost less impairment or at valuation with revaluation surpluses going to a revaluation reserve via the STRGL. Under FRS 102, investments in shares whose fair value cannot be reliably measured are carried at cost less impairment, while those in publicly traded shares or shares whose fair value can be reliably measured are carried at fair value with changes via the profit or loss. Effectively FRS 102 restricts the possibility of revaluing share investments to those that are reliably measurable in terms of fair value, possibly by reference to an active market, while under current UK GAAP revaluation is allowed under the more subjective judgement of the directors that can determine a value that appears to be appropriate to them in view of the company's circumstances. Additionally under FRS 102 changes in the fair value of share investments are recognised in profit or loss and not via other comprehensive income as in current UK GAAP.

The reporting impact of the use of the amortised cost basis for certain debt instruments or of the accounting requirements for financing transactions is difficult to quantify; however, it is likely that the amounts recognised as interest, both payable or receivable, and as carrying value of financial assets and liabilities may materially change compared with the same financial instruments measured under current UK GAAP.

The new requirements for investments in shares will reduce the scope for revaluation of unquoted shares and will also potentially include in the profit or loss substantial gains or losses on investments measured at fair value that would have mainly been reflected in the revaluation reserve under current UK GAAP. Gains on re-measurement at fair value of share investments, although included in retained earnings, may not constitute distributable profits, as they may be regarded as not realised (that is typically the case for unquoted shares), and therefore entities should keep track of such gains and consider them separately when making a distribution.

The potential differences in the amounts measured as interest and financial assets and liabilities under FRS 102 may have an impact on existing loan covenants. In particular differences in the measurement of interest payable may affect the interest cover ratio of an entity and result in a breach. Similarly a material difference in the measurement of liabilities may result in a breach of covenant relating to the gearing ratio. To prevent such consequences, covenants may need to be renegotiated or clarified with lenders where possible.

The inclusion of assets at fair value through profit or loss, like share investments, are also likely to result in substantial differences in reported profits under FRS 102 that may affect remuneration or share based schemes that may be based on reported results. In such a case the schemes will need to be revised so that performance may be measured on results depurated by revaluation of financial instruments.

Transition
Financial assets and liabilities derecognised under an entity's previous accounting framework before the date of transition will not be recognised upon adoption of FRS 102. Conversely, for financial assets and liabilities that would have been derecognised under FRS 102 in a transaction that took place before the date of transition, but that were not derecognised under an entity's previous accounting framework, an entity may choose:

(i) to derecognise them on adoption of FRS 102; or
(ii) to continue to recognise them until disposed of or settled.

Apart from the specific derecognition provisions above, the general transitional procedures in FRS 102 will apply to financial instruments on first-time adoption, ie assets and liabilities will be recognised, reclassified and measured as at the transition date in accordance with FRS 102. For instance derivatives will be recognised if they were not recognised under previous GAAP and investments in traded shares will be remeasured at fair value if they were previously carried at cost.

Taxation impact of the changes
We have already noted that FRS 102 introduces major changes to the rules for the reporting of financial instruments. A financial instrument is defined as "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity". The taxation of financial instruments is, to a large extent, covered by the loan relationship rules.

The computational rules for loan relationships are set out in CTA09/PT5/CH3. The key principles outlined in section 307 and 308 of CTA09 are that the amounts to be brought into the corporation tax computation are the 'credits and debits' which:

- taken together, 'fairly represent' the company's profits and losses from its loan relationships, and are computed in accordance with generally accepted accounting practice (GAAP).

The derivative contract rules introduced in 2002 (now to be found in CTA 2009 Pt. 7) govern the tax treatment of companies which are party to certain options, futures and contracts for difference. Again, the credits and debits to be brought into account are, very broadly, those that are recognised in accordance with generally accepted accounting practice.

The changes introduced by FRS 102 have a major impact on the accounting treatment of financial instruments and, since the taxation treatment broadly follows the accounting treatment under GAAP, this will have a direct impact on the taxation treatment.

The loan relationship regime relies heavily on companies' accounts, with the accounting treatment determining, to a large degree, both the amounts taken into account for tax purposes, and the timing.

FRS 102 makes widespread use of fair value accounting, particularly for derivatives. This creates potential corporation tax volatility on restatement and on an on-going basis.

Transitional adjustments
In most cases, the accounting effects of the restatement of the carrying value of financial instruments on the transition to FRS 102 will be taxable or allowable, as appropriate. However, as explained further below, spreading provisions will apply.

When IFRS was first introduced, the Loan Relationship and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (the COAP regulations) were introduced. The COAP regulations provided that any restatement effects arising on a change of accounting policy, which would otherwise be charged to corporation tax, should be spread over ten years beginning with the accounting period of transition, subject to certain exclusions. The spreading provisions under COAP were introduced to protect the Exchequer from tax loss as well as protecting companies from the effects of volatility.
The COAP provisions will apply in respect of restatements arising from the transition to FRS 102, meaning that the effects of any restatements will need to spread over ten years.

Preparing for the transition
The transition to FRS 102 takes place for accounting periods beginning on or after 1 January 2015 for non-early adopters. For a company with a calendar year-end, the effective date of transition is 1 January 2014, due to the need to reflect the comparatives for 2014 in the 2015 accounts on a similar basis, with restatement effects being computed by reference to the closing balance sheet for 2013.

It will therefore be necessary for companies to consider well in advance whether the transition to FRS 102 is likely to result in material UK corporation tax effects due to restatement.

Some companies might not be aware that they are carrying financial instruments in the shape of interest-rate swaps, foreign exchange contracts, or options and hedges the banks may have added to their loan agreements. As already mentioned FRS 102 includes separate accounting requirements for 'basic' and 'other', more complex financial instruments. The requirements for basic financial assets apply to all entities. If, as in the majority of cases, an entity only enters into basic transactions, it will not need to apply the section of the standard that deals with more complex transactions. Loan contracts should be scrutinised to establish if they involve any derivatives or other financial instruments as this will further complicate matters and trigger the need to apply the section of the standard that deals with more complex financial instruments.

Statement of Cash Flows

Current UK GAAP	FRS 102
FRS 1 requires an entity to prepare a cash flow statement including all the increases and decreases in the amounts of cash classified under nine standard headings: a) operating activities b) dividends from joint ventures and associates c) returns on investments and servicing of finance d) taxation e) capital expenditure and financial investments f) acquisitions and disposals g) equity dividends paid h) management of liquid resources i) financing	FRS 102 requires an entity to present a statement of cash flows providing information about the changes in cash and cash equivalents for a reporting period classified under three headings: a) operating activities b) investing activities and c) financing activities
Cash comprises cash in hand and deposits repayable on demand, ie with a period of notice of not more than one working day, less overdrafts repayable on demand.	Cash is defined as cash on hand and demand deposits. Cash equivalents are defined as short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. An investment with a maturity of three months or less may qualify as a cash equivalent. Bank overdrafts repayable on demand and that are an integral part of cash management are a component of cash and cash equivalents.
FRS 1 requires a separate reconciliation between operating profit and net cash flow from operating activities and a separate reconciliation of net cash flow to movement in net debt.	FRS 102 requires a reconciliation of the amounts of cash and cash equivalents presented in the statement of cash flows to the equivalent items in the statement of financial position.

Reporting and commercial impact of the changes
Compared to current UK GAAP (FRS 1), FRS 102 extends the scope of the statement of cash flows by requiring the inclusion not only of inflows and outflows of cash, defined as cash in hand and demand deposits, and of bank overdrafts repayable on demand, but also of cash equivalents. Cash equivalents include investments with a maturity of three months or less that under FRS 1 are normally classified within management of liquid resources.

The three headings for classification of cash flows also represent a significant reduction on the nine required by FRS 1 and will require careful re-thinking for the reclassification of items on first adoption of FRS 102.

Under FRS 102 operating activities are indicated as the main revenue-producing activities of the entity and therefore cash flows from such activities normally result from transactions that determine the profit or loss of the entity. Examples are:

a) cash receipts and payments for sale or purchase of goods and services;
b) cash payments and refunds of tax, unless they relate specifically to investment of financing activities;

c) cash receipts and payments from investments, loans and other contracts held for dealing or trading purposes, ie those similar to inventory acquired specifically for resale.

However, the cash flows for some transactions that result in a gain or loss, such as the sale of plant by a manufacturing entity, are classified as from investing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples of investing activities cash flows are:

a) cash payments and receipts to acquire or to sell property, plant and equipment, intangible assets and other long-term assets;
b) cash payments and receipts to acquire or sell equity or debt instruments of other entities and interests in joint ventures;
c) cash advances and loans made to other parties and connected repayments;

Financing activities are activities resulting in changes in the size and composition of contributed equity and borrowings of an entity. Examples of cash flows from such activities are:

a) cash proceeds from issuing shares and other equity instruments;
b) cash payments to owners to acquire or redeem the entity's shares;
c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other long-term or short-term borrowings;
d) repayments of amounts borrowed;
e) lessee's payments to reduce a liability on a finance lease.

In respect of interest and dividends, FRS 102 requires that cash flows from interest and dividends paid and received should be presented separately. An entity may classify interest paid and interest and dividends received as operating cash flows. Alternatively interest paid may be classified as financing cash flows and interest and dividends received as investing cash flows. Dividends paid may be classified as financing cash flows because they are a cost of obtaining financial resources. Alternatively they may be classified as a component of cash flows from operating activities because they are paid out of operating cash flows.

Transition
There are no specific transitional provisions in FRS 102 in respect of the statement of cash flows; however, comparatives consistent with the presentation under FRS 102 will need to be presented on first-time adoption.

Consolidated Financial Statements and Accounting for Business Combinations

Current UK GAAP	FRS 102
FRS 2 requires a parent undertaking to prepare consolidated financial statements unless it is exempted from doing so under the provisions of Companies Act 2006.	FRS 102 mirrors FRS 2 as a parent is required to prepare consolidated financial statements unless it is exempt under the provisions of Companies Act 2006.
Under FRS 6 acquisition accounting should be used for business combinations not accounted for by merger accounting. FRS 6 requires a business combination to be accounted for by using merger accounting if the combination meets the specific criteria to qualify as a merger and also meets the conditions for the use of merger accounting in company legislation.	Under FRS 102 all business combinations should be accounted for by applying the purchase method except for some involving public benefit entities.
A group reconstruction may be accounted for by using merger accounting even if the definition of merger in FRS 6 is not met.	Group reconstructions may be accounted for by using the merger accounting method.

Reporting and commercial impact of the changes
The requirements for the preparation of consolidated accounts are unchanged under FRS 102 compared with current UK GAAP. In particular exemptions from preparing group accounts are based on the provisions of Companies Act 2006. FRS 102 also maintains that a parent is not required to prepare group accounts if all its subsidiaries are excluded from consolidation. In particular a subsidiary has to be excluded from consolidation where severe long-term restrictions over its management or assets exist or if the interest in it is held exclusively with a view to subsequent resale. Additionally a subsidiary may be excluded if its inclusion is not material, individually or collectively for more than a subsidiary, for the purposes of giving a true and fair view in the context of the group.

Business combinations are defined in FRS 102 as the bringing together of separate entities or businesses into one reporting entity, ie the acquisition of the equity of another entity or the purchase of all or some of the net assets of another entity that together form a business. Under FRS 102 all business combinations should be accounted for by using the purchase method (acquisition accounting), except for group reconstructions meeting certain conditions which may be accounted for by merger accounting.

Under current UK GAAP, ie FRS 6 Acquisitions and Mergers, if a business combination meets the specific criteria to be classified as a merger then it should be accounted for using merger accounting, unless prohibited by companies legislation; while merger accounting is allowed for group reconstructions in certain circumstances. In contrast FRS 102 does not allow or require the use of merger accounting even for ‘genuine’ mergers and therefore the main impact of such a change is that an acquirer will always need to be identified for accounting purposes. However, FRS 102 maintains the use of merger accounting for group reconstructions, including for example the addition of a new parent to a group or the transfer of the shares in a subsidiary from a group entity to another, when the use of merger accounting is not prohibited by company law, the ultimate equity holders remain the same with the same rights in respect of each other and no non-controlling interest (minority interest) is altered by the transfer.

In commercial terms the fact that an acquirer will always need to be identified for financial reporting purposes, even in the circumstances of a genuine merger, may create problems, as the parties involved and purported to be acquirers or acquisition targets may not accept a financial reporting representation of the business combination that does not reflect its commercial reality. The potential impact of the required accounting treatment for mergers will need to be carefully assessed in respect of the various stakeholders of the entities involved, such as shareholders, finance providers, employees and suppliers, to verify whether it would be acceptable to the parties involved or whether it would imply renegotiations/adjustments of financing/shareholders agreements or employees/suppliers contracts. It may be possible to see that the successful completion of a merger may depend on the fact that the acquisition of one entity by another, as depicted in the financial statements, is acceptable to the stakeholders involved.

Transition
A first-time adopter of FRS 102 may elect not to apply the business combinations provisions to combinations effected before the date of transition. In such a case the entity shall recognise, reclassify and measure, as at the date of transition, all its assets and liabilities acquired or assumed in a past business combination in accordance with the various relevant provisions in FRS 102, apart from a few exceptions including:

- intangible assets other than goodwill, as intangible assets subsumed within goodwill shall not be separately recognised
- goodwill, as no adjustment shall be made to the carrying value of goodwill
- accounting estimates, such as amortisation, depreciation and provisions
- financial assets and liabilities derecognised under previous accounting standards.

If a first-time adopter restates any business combination to comply with FRS 102, it shall restate all later business combinations.

Deferred Tax

Current UK GAAP	FRS 102
FRS 19 requires that deferred tax should be recognised in respect of all **timing differences** that have originated but not reversed by the balance sheet date; and should not be recognised on permanent differences.	Deferred tax shall be recognised in respect of all **timing differences** at the reporting date. Timing differences are differences between taxable profits and total comprehensive income, arising from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in the accounts.
Deferred tax should not be recognised on timing differences arising when non-monetary assets are **revalued**, unless, by the balance sheet dates, the reporting entity has entered into a binding agreement to sell the revalued asset and recognised the gains and losses expected to arise on sale.	Deferred tax relating to a non-depreciable asset that is measured using the **revaluation** model, or to investment properties measured at fair value, shall be measured using the tax rates and allowances that apply to the sale of the asset.
Tax that could be payable on any future remittance of the past earnings of a subsidiary, associate or joint venture should be provided for only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute the past earnings in the future has been entered into.	Deferred tax shall be recognised when income or expenses from a subsidiary, associate, branch or interest in a joint venture have been recognised in the financial statements and will be assessed to or allowed for tax in a future period, except where the reporting entity is able to control the reversal of the timing difference and it is probable that the timing difference will not reverse in the near future. When the amount that can be deducted for tax for an asset (other than goodwill) that is recognised in a business combination is less (more) than the value at which it is recognised, a deferred tax liability (asset) shall be recognised for the additional tax that will be paid (avoided) in respect of that difference. Similarly, a deferred tax asset (liability) shall be recognised for the additional tax that will be avoided (paid) because of a difference between the value at which a liability is recognised and the amount that will be assessed for tax.

Reporting and commercial impact of the changes
The main impact on financial reporting is likely to be additional deferred tax provisions relating to revaluations which may affect the results of the entity by reducing its distributable profits; however, a deferred tax provision in respect of a gain on an investment property measured at fair value is not treated as a realised loss, ie as a reduction in distributable profits, as such gain is regarded as unrealised. Additionally there will be an increase in provisions on the balance sheet.

Transition
The transition section of the standard is silent on the treatment of deferred tax and accordingly the general transitional procedures in FRS 102 will apply to deferred tax on first-time adoption, ie assets and liabilities will be recognised, reclassified and measured as at the transition date in accordance with FRS 102. For instance a deferred tax liability may need to be recognised at transition date in respect of a gain on an investment property remeasured at fair value on first-time adoption.

5. SUMMARY

This factsheet highlights and analyses the main changes to UK GAAP introduced by FRS 102 from a financial reporting, commercial and taxation perspectives. The analysis does not purport to be conclusive or exhaustive of the issues treated but rather to constitute a thinking springboard that could help readers familiarise with topical areas of the new standard in anticipation of its adoption.

This guidance is made having regard to the standards, laws and regulation in force as at 15 August 2013.