

Technical factsheet

FRS 102 – transition issues for small companies

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# INTRODUCTION

FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, has been in issuance since March 2013 and applies mandatorily for companies not eligible to apply the small companies regime in the preparation of their financial statements for accounting periods starting on or after 1 January 2015, with earlier adoption permissible. Small companies will be moved under the scope of FRS 102 mandatorily for accounting periods starting on or after 1 January 2016.

FRS 102 is based on the principles found in International Financial Reporting Standards (IFRSs), specifically *IFRS for SMEs*. *IFRS for SMEs* is intended to apply to general-purpose financial statements by entities which are classed as ‘small and medium-sized’ or ‘private’ and ‘non-publicly accountable’. The term ‘publicly accountable’ was difficult to define in the context of legislation and hence is not a recognised concept in UK GAAP.

While FRS 102 is based on the principles found in *IFRS for SMEs*, the Financial Reporting Council (FRC) has modified the requirements significantly, both in terms of the scope of entities eligible to apply the standard and the accounting treatments provided. A notable area where the FRC has substantially modified the content of *IFRS for SMEs* to arrive at FRS 102 is in relation to section 29, ‘Income Tax’; which is significantly different from the equivalent section 29 in *IFRS for SMEs*.

At the time of writing, the latest edition of FRS 102 is the September 2015 edition, which superseded the August 2014 edition in respect of the following:

a. an editorial amendment to section 12, ‘Other Financial Instruments Issues’,in relation to the examples on hedge accounting, which were issued in September 2014

b. *Amendments to FRS 102 – Pension obligations*, which was issued in February 2015

c. consequential amendments to FRS 102 that were included in FRS 104, *Interim Financial Reporting*,issued in March 2015

d. inclusion of section 1A, ‘Small Entities’,and other minor amendments

e. some minor typographical or presentational corrections.

FRS 102 is divided into sections, and each section is organised by topic area. Cross-references to paragraphs within the standard are identified by section followed by paragraph number. Paragraph numbers are in the form of ‘xx.yy’, where ‘xx’ is the relevant section number and ‘yy’ is the sequential paragraph number within that section. Paragraphs which apply only to ‘public benefit entities’ are preceded by ‘PBE’. Where FRS 102 provides examples of how certain principles are applied in the context of the standard which include monetary amounts, the measuring unit is the ‘currency unit’ (CU).

# Standards in issue and withdrawal of the *FRSSE*

FRS 102 is part of a suite of standards that form ‘new UK GAAP’. The standards are listed below, together with the dates of the latest editions in issue at the time of writing this Technical Factsheet:

[FRS 100, *Application of Financial Reporting Requirements*](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-100-Application-of-Financial-Reporting-Requir.pdf)(September 2015)

[FRS 101, *Reduced Disclosure Framework*](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-101-Reduced-Disclosure-Framework-%281%29.pdf) (September 2015)

[*FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland*](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicab.pdf) (September 2015)

[FRS 103, *Insurance Contracts*](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-103-Insurance-Contracts.aspx) (March 2014)

[Amendments to FRS 103, *Insurance Contracts* – Solvency II](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Amendments-to-FRS-103-Insurance-Contracts-Solve.aspx) (May 2016)

[FRS 104, *Interim Financial Reporting*](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-104-Interim-Financial-Reporting.aspx) (March 2015)

[FRS 105, *The Financial Reporting Standard applicable to the Micro-entities Regime*](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-105-The-Financial-Reporting-Standard-applicab.pdf) (July 2015)

[Amendments to FRS 105, *Limited Liability Partnerships and Qualifying Partnerships*](https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Amendments-to-FRS-105-The-Financial-Reporting-Sta.pdf) (May 2016)

The[*FRSSE*](https://www.frc.org.uk/Our-Work/Corporate-Governance-Reporting/Accounting-and-Reporting-Policy/FRSSE.aspx) (effective January 2015) is withdrawn in its entirety for accounting periods starting on or after 1 January 2016. The FRC came to the conclusion that the *FRSSE* is unsustainable in its current form because it requires more disclosures than is permitted by the EU Accounting Directive (‘the directive’). As noted above, small companies will be moved under the scope of FRS 102 but with reduced disclosure requirements.

# Amendments to the Companies Act 2006 (SI 2015/980)

On 26 March 2015, [Statutory Instrument (SI) 2015/980](http://www.legislation.gov.uk/uksi/2015/980/contents/made) received Royal Assent and became effective on 6 April 2015. It will apply to accounting periods starting on or after 1 January 2016 (with early adoption permitted – see below). SI 2015/980 implements the provisions of the EU Accounting Directive (the directive) into company law. The directive was issued in June 2013 and member states were given until July 2015 in which to transpose the provisions of the directive into legislation.

The overarching objective of the directive is to seek to reduce the burdens placed on small companies in terms of the disclosures that they are legally required to make in their financial statements. In addition to the reduced disclosure requirements, another notable feature of the revised Companies Act 2006 is the increase in the size thresholds which determine the size of a company. The revised thresholds are set out in the table below:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Turnover** | **Balance sheet total** | **Average number of employees** |
| Micro-entity | Not more than £632,000 | Not more than £316,000 | Not more than 10 |
| Small company  | Not more than £10.2m | Not more than £5.1m | Not more than 50 |
| Small group  | Not more than £10.2m net or not more than £12.2m gross  | Not more than £5.1m net or not more than £6.1m gross  | Not more than 50 |
| Medium-sized company  | Not more than £36m  | Not more than £18m | Not more than 250 |
| Medium-sized group  | Not more than £36m net or not more than £43.2m gross  | Not more than £18m net or not more than £21.6m gross  | Not more than 250 |
| Large company | More than £36m | More than £18m | 250 or more |
| Large group  | More than £36m net or more than £43.2m gross | More than £18m net or more than £21.6m gross | 250 or more |

The qualifying conditions above are met by a company, or a group, in a year in which it satisfies two, or more, of the turnover, balance sheet total and employee headcount criteria. Section 382(4) of the Companies Act 2006 says that if a company has a short accounting period, the turnover figure must be proportionately adjusted.

SI 2015/980 contains an early adoption clause which allows an entity to early adopt the provisions of the revised Companies Act 2006 for accounting periods starting on or after 1 January 2015, but before 1 January 2016, if the directors so wish. Where an entity early adopts the new legislation, it must ensure that it also:

* applies the provisions in new UK GAAP. A company that was previously medium-sized but is now small under the revised size thresholds must not use the *FRSSE* (effective January 2015) in the preparation of, say, the 31 December 2015 financial statements; if the entity early adopts the revised legislation, it must early adopt the new suite of standards
* does not early adopt the revised audit exemption thresholds as there is no option to early adopt the increased audit exemption thresholds (which have been aligned to the small company size thresholds noted in the table above)
* does not prepare abbreviated financial statements as the concept of such accounts has been abolished in SI 2015/980.

# Reduced disclosure requirements and the true and fair concept

The small companies and micro-entities choosing not to apply FRS 105, *The Financial Reporting Standard applicable to the Micro-entities Regime,* must adopt FRS 102 for accounting periods starting on or after 1 January 2016 (although early adoption is permissible). FRS 102 contains a section specifically for small companies referred to as section 1A, ‘Small Entities’,which was first introduced into the September 2015 edition of FRS 102. Section 1A outlines the **presentation** and **disclosure** requirements only. In terms of **recognition** and **measurement** of amounts in the financial statements, the provisions of **full** FRS 102 apply.

Section 1A of FRS 102 is structured as follows:

|  |  |
| --- | --- |
| **Section** | **Paragraphs** |
| Scope of this section  | 1A.1 to 1A.4 |
| True and fair view  | 1A.5 to 1A.6 |
| Complete set of financial statements of a small entity | 1A.7 to 1A.11 |
| Information to be presented in the statement of financial position  | 1A.12 to 1A.13 |
| Information to be presented in the income statement | 1A.14 to 1A.15 |
| Information to be presented in the notes to the financial statements | 1A.16 to 1A.20 |
| Voluntary preparation of consolidated financial statements | 1A.21 to 1A.22 |

There are four appendices attached to section 1A as follows:

Appendix A *Guidance on adapting the balance sheet formats*

Appendix B *Guidance on adapting the profit and loss account formats*

Appendix C *Disclosure requirements for small entities*

Appendix D *Additional disclosures encouraged for small entities*

Appendix C outlines the disclosures required by law as follows:

|  |  |
| --- | --- |
| **Disclosure requirements** | **Paragraphs** |
| Accounting policies | 1AC.3 to 1AC.6 |
| Changes in presentation and accounting policies and corrections of prior period errors | 1AC.7 to AC.9 |
| True and fair override | 1AC.10 |
| Notes supporting the statement of financial position  | 1AC.11 |
| Fixed assets  | 1AC.12 to 1AC.13 |
| Fixed assets measured at revalued amounts | 1AC.14 to 1AC.18 |
| Capitalisation of borrowing costs  | 1AC.19 |
| Impairment of assets | 1AC.20 to 1AC.21 |
| Fair value measurement  | 1AC.22 to 1AC.25 |
| Financial instruments measured at fair value  | 1AC.26 |
| Indebtedness, guarantees and financial commitments | 1AC.27 to 1AC.31 |
| Notes supporting the income statement | 1AC.32 to 1AC.33 |
| Related party disclosures  | 1AC.34 to 1AC.36 |
| Other | 1AC.37 to 1AC.39 |

The requirement to prepare financial statements which give a true and fair view is contained in section 393 of the Companies Act 2006 and there have not been any changes to this concept. The directors of a small company still have a legal duty to ensure the entity’s financial statements give a true and fair view, and they will be committing a criminal offence if they fail to comply with the true and fair requirement. The FRC has acknowledged that this will place an added burden on directors because merely applying the minimum legal requirements may not be sufficient in order to achieve a true and fair view, and in this respect additional disclosures beyond the requirements of the law will be needed.

The directive restricts member states from imposing additional disclosures over and above those required by law. However, as noted above, the mere application of the legally required minimum may not be sufficient to comply with the requirement to prepare true and fair financial statements.

In light of this, the FRC has included Appendix D to section 1A, which outlines five **encouraged** disclosures which small entities should consider making, as follows:

a. a statement of compliance with FRS 102 as set out in paragraph 3.3, adapted to refer to section 1A

b. a statement that it is a public benefit entity as set out in paragraph PBE3.3A

c. the disclosures relating to going concern set out in paragraph 3.9

d. dividends declared and paid or payable during the period (for example, as set out in paragraph 6.5(b))

e. on first-time adoption of FRS 102, an explanation of how the transition has affected its financial position and financial performance as set out in paragraph 35.13.

Paragraph 1A.17 of FRS 102 acknowledges that, while a small entity is not required to comply with the disclosure requirements of section 3 (to the extent set out in paragraph 1A.7) and sections 8 to 35 of FRS 102, it does refer to the disclosure requirements of those specific sections as usually being considered relevant to giving a true and fair view. As a result, paragraph 1A.17 advises small entities to consider and provide any of those disclosures which are relevant to material transactions, other events or conditions of the small entity in order to meet the requirement to prepare true and fair financial statements. Conversely, a small entity need not provide specific disclosures if the information is not material.

# Transition to FRS 102

For the vast majority of small entities, the transition to FRS 102 will take place for an accounting period which starts on or after 1 January 2016 (ie December 2016 year-ends). As with companies outside of the small companies’ regime, a small entity transitioning to FRS 102 must apply the rules in FRS 102 retrospectively to the date of transition and apply the principles in section 35, ‘Transition to this FRS’, on first-time adoption of FRS 102. Other than disclosure requirements, the same principles will be applied by small companies as medium-sized and large entities will apply on transition to FRS 102.

The objective of this restatement process is so that the financial statements reflect the provisions in FRS 102 as if the standard had always been the framework used by the entity. Retrospective application will enable the financial statements to be both comparable and consistent because otherwise it would be meaningless to have the current year’s financial statements prepared under FRS 102, with the previous period prepared under previous UK GAAP (ie the FRSSE). Retrospective restatement is needed as far back as the date of transition so that the opening balances, on which the comparative year is built, reflect the provisions in FRS 102.

A first-time adopter must apply section 35 in the first set of financial statements that comply with FRS 102. An entity’s ‘first set of financial statements that comply with FRS 102’ are those that contain an *explicit and unreserved* statementof compliance with FRS 102, where the small entity provides this encouraged statement to comply with paragraph 1AD.1(a). Paragraph 35.4 provides three examples of when financial statements prepared under the principles of FRS 102 are an entity’s first such financial statements as follows:

a. the entity did not present financial statements for previous periods

b. the entity presented its most recent previous financial statements under previous UK and Republic of Ireland requirements that are therefore not consistent with FRS 102 in all respects, or

c. the entity presented its most recent previous financial statements in conformity with EU-adopted IFRS.

The standard requires an entity to disclose comparative information in respect of the previous accounting period for all amounts presented in the financial statements and specified comparative narrative and descriptive information. The majority of reporting entities in the UK and Republic of Ireland will provide current year financial information and the previous period’s/year’s comparatives; however, the standard does permit an entity to present more than one preceding period (although in practice this is not usually the case).

Where an entity is applying FRS 102 for the first time and only presents one preceding period of comparative information, the entity will need to make adjustments to:

* the comparative statement of financial position (balance sheet)
* the comparative profit and loss account (income statement)
* the opening statement of financial position (balance sheet) at the date of transition.

The transition procedures can be looked at as a stage of five steps:

**Step 1:** determine the date of transition

**Step 2:** recognise all assets and liabilities whose recognition is required by FRS 102

**Step 3:** derecognise items as assets or liabilities if FRS 102 does not permit such recognition

**Step 4:** reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under FRS 102

**Step 5:** apply FRS 102 in measuring all recognised assets and liabilities.

## Transitional versus prior period adjustments

It should be noted that the accounting policies that an entity uses in its opening balance sheet under FRS 102 could differ from those that it used as at the same date under previous UK GAAP. This is because previous UK GAAP may have permitted certain accounting treatments, whereas FRS 102 may not permit such accounting treatments, and vice versa. Any adjustments that are made to the entity’s opening balance sheet position as a result of aligning accounting policies to achieve compliance with FRS 102 are known as ‘transitional adjustments’.

With the exception of some specified exemptions, the rules must be applied to the prior period comparative financial statements and these adjustments are referred to as ‘prior period adjustments’. It is important to distinguish between the two types of adjustments. Some examples of adjustments that might be made to a category of equity, other than retained earnings, include:

* amounts in respect of remeasuring derivative financial instruments that are subject to hedge accounting under section 12, ‘Other Financial Instruments Issues’
* any difference between the cost of an item of property, plant and equipment and fair value where the entity uses a deemed cost, or where a policy of revaluing the asset(s) is adopted on transition to FRS 102
* deferred tax that is recognised for the first time on items of property, plant and equipment measured under the revaluation model and that has been included in the same reserve as the revaluation gain.

## Determining the date of transition

The date of transition is the start date of the earliest period reported in the financial statements.

***Example 1: determining the date of transition***

Company A Ltd is preparing its first set of FRS 102 financial statements for its year ended 31 March 2017 and the financial controller is unsure as to the entity’s date of transition. The company only includes the preceding year’s financial statements as comparatives.

The date of transition is the start date of the earliest period reported in the accounts. The comparative year ended on 31 March 2016 and it started on 1 April 2015; therefore 1 April 2015 is the entity’s date of transition.

Company B Ltd is preparing its first set of FRS 102 financial statements for its year ended 31 July 2017 and the accounts senior is unsure as to the entity’s date of transition. The company only includes the preceding year’s financial statements as comparatives.

In Company B’s case, the date of transition will be 1 August 2015, being the start date of the earliest period reported in the financial statements.

It should be noted that in all cases, reporting entities’ dates of transition will have been and gone.

## Mandatory exemptions from retrospective application

Paragraph 35.9 of FRS 102 prohibits a first-time adopter from retrospectively changing the accounting that it followed under its previous GAAP for any of the following types of transactions:

### Derecognition of financial assets and financial liabilities

Where financial assets and financial liabilities were derecognised under previous UK GAAP prior to the date of transition, they are not to be recognised on transition to FRS 102. Also, where a financial asset or a financial liability (or group of financial assets and financial liabilities) would have been derecognised under FRS 102 in a transaction which took place prior to the date of transition, but which has not been derecognised under previous UK GAAP, the entity can either derecognise them on adoption of FRS 102, or continue to recognise them until they are either disposed of or settled.

### Accounting estimates

Accounting estimates at the date of transition cannot be changed for the benefits of hindsight. Therefore, if the reporting entity had a provision for liabilities at its date of transition, but now knows the outcome of the event or condition that gave rise to that provision, it cannot retrospectively change the amount of the estimate.

### Discontinued operations

The entity must not change the accounting that it followed under previous GAAP for discontinued operations. Therefore, no reclassification or remeasurement will be recognised for discontinued operations that have been accounted for under previous UK GAAP.

### Non-controlling interests

The entity must not retrospectively change the accounting that it followed under previous UK GAAP for measuring non-controlling interests (referred to as ‘minority interests’ in previous GAAP). The requirements to:

* allocate profit or loss and total comprehensive income between non-controlling interests and owners of the parent,
* account for changes in the parent’s ownership interest in a subsidiary which do not result in a loss of control, and
* account for a loss of control over a subsidiary

must be applied **prospectively** from the date of transition to FRS 102, or from such earlier date as FRS 102 is applied to restate business combinations (see the next section of this technical factsheet, ‘Optional exemptions from retrospective application’).

## Optional exemptions from retrospective application

Paragraph 35.10 contains 21 **optional** exemptions from retrospective application of FRS 102, which a first-time adopter may wish to take advantage of in its first set of FRS 102 financial statements. Small entities have an additional three optional exemptions available to them in respect of:

* share-based payment transactions
* fair value measurement of financial instruments
* financing transactions involving related parties.

In respect of the optional exemptions, a small entity can take advantage of all, some or none of them as applicable. In the vast majority of cases, it is unlikely that a small entity will be able to take advantage of all of the optional exemptions.

### Business combinations, including group reconstructions

A first-time adopter does not have to apply section 19, ‘Business Combinations and Goodwill’, to those business combinations that took place *before* the date of transition. However, where the entity restates any business combination so as to comply with section 19, it must restate all later business combinations. Where the provisions in section 19 are not applied retrospectively, all assets and liabilities acquired or assumed in a past business combination at the date of transition will be recognised and measured in accordance with paragraphs 35.7 to 35.9 (or, if applicable, paragraphs 35.10(b) to (r)). There are, however, two exceptions in respect of:

* + intangible assets (not goodwill): intangible assets subsumed within goodwill should not be recognised separately
	+ goodwill: no adjustment is made to the carrying amount of goodwill.

### Share-based payment transactions

For equity instruments granted *before* the date of transition, a first-time adopter does not have to apply section 26, ‘Share-based Payment’. This exemption also applies to liabilities arising from share-based payment transactions that were settled prior to the date of transition.

Where a first-time adopter has previously applied either FRS 20, *Share-based payment*,or IFRS 2, *Share-based Paymen*t*,* to equity instruments granted BEFORE the date of transition, the entity must then apply FRS 20/IFRS 2 (as applicable) or section 26 at the date of transition.

For a small entity that first adopts FRS 102 for an accounting period starting before 1 January 2017, this exemption is extended to equity instruments that were granted before the start of the first reporting period that complies with FRS 102, provided that the small entity did not previously apply FRS 20 or IFRS 2. Where a small entity chooses to apply this exemption, it must provide disclosures in accordance with paragraph 1AC.31, which relates to off-balance sheet arrangements.

### Fair value as deemed cost

For items of property, plant and equipment (section 17, ‘Property, Plant and Equipment’), investment property (section 16, ‘Investment Property’) or intangible assets excluding goodwill (section 18, ‘Intangible Assets other than Goodwill’), a first-time adopter can use fair value as deemed cost on transition to FRS 102. The term ‘deemed cost’ is defined in the glossary as:

*‘An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent* ***depreciation*** *or* ***amortisation*** *assumes that the entity had initially recognised the* ***asset*** *or* ***liability*** *at the given date and that its cost was equal to the deemed cost.’*

### Revaluation as deemed cost (see example 2 below)

Again, for items of property, plant and equipment, investment property or intangible assets other than goodwill, a first-time adopter can use a revaluation amount as deemed cost. This may be of particular benefit to a client who wants to stop getting periodic revaluations and move back onto the depreciated historic cost model for its property, plant and equipment. Care must be taken with this exemption because the valuations used as deemed cost should be either at the date of transition or before the date of transition, **but not after**.

### Individual and separate financial statements

Paragraphs 9.26, 14.4 and 15.9 of FRS 102 require an entity to account for investments in subsidiaries, associates and jointly controlled entities at either cost less impairment or at fair value in the individual or separate financial statements. Where cost is used, the first-time adopter must use one of the following amounts in the individual/separate opening balance sheet:

* + cost per section 9, ‘Consolidated and Separate Financial Statements’, section 14, ‘Investments in Associates’ or section 15, ‘Investments in Joint Ventures’, or
	+ deemed cost – in this respect the deemed cost is the carrying amount at the date of transition which has been determined under previous UK GAAP.

### Compound financial instruments

‘Split accounting’ is used for compound financial instruments (where the debt and equity components of the instruments are accounted for separately). A first-time adopter does not have to use split accounting if the liability portion of the instrument has been settled at the date of transition.

### Service concession arrangements

A service concession arrangement is defined in the glossary as:

*‘An arrangement whereby a public sector body or a* ***public benefit entity*** *(the grantor) contracts with a private sector entity (the operator) to construct (or upgrade), operate and maintain* ***infrastructure assets*** *for a specified period of time (the concession period).’*

For such arrangements, a first-time adopter does not have to apply the provisions in paragraphs 34.12I to 34.16A for service concession arrangements entered into prior to the date of transition as these arrangements will continue to be accounted for using the same accounting policies applied at the date of transition.

### Extractive industries

Where a first-time adopter has previously accounted for exploration and development costs for oil and gas properties that are in the development/production phase in cost centres that included all properties in a large geographical area, it can choose to measure oil and gas assets at the date of transition on the following basis:

* + exploration and evaluation assets at the amount determined under previous UK GAAP
	+ assets in the development/production phase at the amount determined for the cost centre under previous UK GAAP. (This amount will be allocated to the cost centre’s underlying assets on a pro-rata basis using reserve volumes or values at the date of transition.)

First-time adopters must test exploration and evaluation assets in the development and production phases for impairment at the date of transition in accordance with either section 34, ‘Specialised Activities’ or section 27, ‘Impairment of Assets’.

### Arrangements containing a lease

First-time adopters can choose to determine whether an arrangement that exists at the date of transition contains a lease on the basis of facts and circumstances existing at the date of transition, rather than when the lease was originally entered into.

### Decommissioning liabilities included in the cost of property, plant and equipment (PPE)

The cost of an item of PPE should include the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. A first-time adopter can choose to measure this portion of the cost at the date of transition rather than on the date(s) when the obligation initially arose.

### Dormant companies

A company that is dormant (as defined in the Companies Act 2006) can retain its accounting policies for reported assets, liabilities and equity at the date of transition until such time that there is a change to those balances or the company enters into new transactions.

### Deferred development costs as deemed cost

The carrying amount of development costs capitalised under previous UK GAAP can be used as deemed cost on transition to FRS 102.

### Lease incentives (see example 3 below)

A first-time adopter does not have to apply paragraphs 20.15A and 20.25A to lease incentives provided that the lease was entered into before the date of transition. The first-time adopter can continue to recognise any remaining lease incentive (or cost associated with lease incentives) on the same basis as that applied at the date of transition to FRS 102.

### Public benefit entity combinations

A first-time adopter does not have to apply paragraphs PBE34.75 to PBE34.86 to public benefit combinations that had taken place prior to the date of transition. However, if the first-time adopter restates any entity combination to comply with FRS 102, it must restate all later entity combinations.

### Assets and liabilities of subsidiaries, associates and joint ventures

When a subsidiary becomes a first-time adopter later than its parent, the subsidiary measures its assets and liabilities at either:

1. the carrying values that would be included in the parent’s consolidated accounts. These values are based on the parent’s date of transition to FRS 102 if no consolidation adjustments were made and for the effects of the business combination in which the parent acquired the subsidiary, or
2. the carrying values required by the rest of FRS 102, which are based on the subsidiary’s date of transition.

The carrying values in 2 could be different from in 1 where the exemptions result in measurements that are dependent on the date of transition. In addition, differences could arise where the accounting policies used by the subsidiary differ from those in the consolidated accounts.

Similar exemptions are available for an associate or joint venture that become a first-time adopter later than the entity that holds significant influence or joint control over it.

Conversely, where the parent or investor becomes a first-time adopter later than its subsidiary, associate or joint venture, the parent/investor will, in the consolidated financial statements, measure the assets and liabilities of the subsidiary, associate or joint venture at the same carrying value as in the subsidiary’s, associate’s or joint venture’s financial statements. This takes into account consolidation and equity accounting adjustments as well as the effects of the business combination in which the parent acquired the subsidiary or transaction in which the entity acquired the associate or joint venture.

Where the parent becomes a first-time adopter in respect of its separate financial statements earlier or later than for its consolidated accounts, the parent measures its assets and liabilities at the same value in both sets of accounts, except for consolidation adjustments.

### Designation of previously recognised financial instruments

FRS 102 allows a financial instrument to be designated on initial recognition as a financial asset or financial liability at fair value through profit or loss, provided certain criteria are met. A first-time adopter can designate any financial asset or financial liability at fair value through profit or loss provided that the asset or liability meets the criteria in paragraph 11.14(b) at the date of transition.

### Hedge accounting

There are exemptions available in respect of hedge accounting that may be applied in respect of:

* + a hedging relationship existing at the date of transition
	+ a hedging relationship which ceased to exist at the date of transition because the hedging instrument had expired, was sold, terminated or exercised prior to the date of transition
	+ a hedging relationship which commenced subsequent to the date of transition
	+ entities that choose to take the accounting policy choice under paragraphs 11.2(b) or (c), or paragraphs 12.2(b) or (c), and apply IAS 39, *Financial Instruments: Recognition and Measurement*,or IFRS 9, *Financial Instruments*.

### Small entities – fair value measurement of financial instruments

A small entity that adopts FRS 102 for an accounting period starting before 1 January 2017 does not need to restate comparative information to comply with the fair value measurement requirements of section 11, ‘Basic Financial Instruments’or section 12, ‘Other Financial Instruments Issues’, unless those instruments were measured at fair value under previous UK GAAP. A small entity that chooses to present comparative information which does not comply with the fair value measurement requirements of sections 11 and 12 in its first year of adoption must:

a. apply its existing accounting policies to the relevant financial instruments in the comparative information and is encouraged to disclose this fact

b. disclose the accounting policies applied (in accordance with paragraph 1AC.3)

c. treat any adjustment between the statement of financial position at the comparative period’s reporting date and the statement of financial position at the start of the first reporting period that complies with section 11 and 12 as an adjustment, in the current reporting period, to opening equity.

### Small entities – financing transactions involving related parties

A small entity that first adopts FRS 102 for an accounting period which starts before 1 January 2017 is not required to restate comparative information to comply with the requirements of paragraph 11.13 only insofar as they relate to financing transactions involving related parties.

A small entity that chooses to present comparative information which does not comply with the financing transaction requirements of section 11 in its first year of adoption must:

a. apply its existing accounting policies to the relevant financial instruments in the comparative information and is encouraged to disclose this fact

b. disclose the accounting policies applied (in accordance with paragraph 1AC.3)

c. treat any adjustment between the statement of financial position at the comparative period’s reporting date and the statement of financial position at the start of the first reporting period that complies with paragraph 11.13 as an adjustment, in the current reporting period, to opening equity. The present value of the financial asset or financial liability at the start of the first reporting period that complies with FRS 102 may be determined on the basis of the facts and circumstances, which exist at that date, rather than the date on which the arrangement was entered into.

***Example 2: revaluation as deemed cost***

Under previous UK GAAP, Company A Ltd always reported its freehold buildings using the revaluation model and obtained updated valuations every five years, as well as valuations in the intervening years where evidence suggested that there had been a material change in value.

The board of directors have decided that the use of the revaluation model is no longer appropriate for the business and have enquired as to whether they can measure the freehold buildings using the historic cost model.

Under previous UK GAAP, a change from the depreciated historic cost model to the revaluation model would have been classed as a change in accounting policy (as it would be under FRS 102 principles). An accounting policy is changed by an entity so that the financial statements give more relevant and reliable information and it is generally accepted that regular valuations are more reliable than historic cost. In view of this principle, it is inherently difficult to switch back from the revaluation model to the historic cost model because an entity would struggle to justify how historic cost provides more relevant and reliable information over up-to-date valuations.

However, in Company A’s situation, the company is transitioning to a whole new financial reporting framework and hence it is possible to use a revalued amount as deemed cost (as per paragraph 35.10(d)), provided that the date of the valuation is either at, or before, the date of transition. GAAP valuations cannot be obtained after the date of transition and then be used as deemed cost. Advance planning is advisable where an entity wishes to take advantage of revaluations as deemed cost to ensure an appropriate valuation is obtained.

***Example 3: lease incentive restatement***

Company B Ltd enters into a 10-year lease to occupy a commercial building on 1 January 2012. Annual rentals amount to £100,000 and the landlord has agreed to a one-year rent-free period. The terms of the lease provide for a break-clause at the end of year five, after which rental payments are to revert to market rate. Company B has an accounting reference date of 31 December and its date of transition is 1 January 2015.

Under previous UK GAAP the lease incentive would be amortised up to the point at which lease rentals revert to market rate (ie from years six to 10), hence the lease profile would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Paid** | **Charge to P&L** | **Balance c/f** |
| **Year end** | **£'000** | **£'000** | **£'000** |
| 31.12.2012 | - | 80 | 80 |
| 31.12.2013 | 100 | 80 | 60 |
| 31.12.2014  | 100 | 80 | 40 |
| 31.12.2015 | 100 | 80 | 20 |
| 31.12.2016 | 100 | 80 | - |

*Option 1: restate the lease incentive to comply with FRS 102 principles*

Section 20, ‘Leases’,in FRS 102 does not consider break clauses and instead requires lease incentives to be written off *over the term of the lease*. Therefore, under FRS 102, the lease profile would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Paid** | **Charge to P&L** | **Balance c/f** |
| **Year end** | **£'000** | **£'000** | **£'000** |
| 31.12.2012 | - | 90 | 90 |
| 31.12.2013 | 100 | 90 | 80 |
| 31.12.2014 | 100 | 90 | 70 |
| 31.12.2015 | 100 | 90 | 60 |
| 31.12.2016 | 100 | 90 | 50 |
| 31.12.2017 | 100 | 90 | 40 |
| 31.12.2018 | 100 | 90 | 30 |
| 31.12.2019 | 100 | 90 | 20 |
| 31.12.2020 | 100 | 90 | 10 |
| 31.12.2021 | 100 | 90 | - |

To restate the lease incentive to FRS 102, the transitional adjustment at 1 January 2015 is as follows:

Dr retained earnings £30k

Cr balance sheet incentive £30k

*being the difference between £70k at 31.12.2014 under FRS 102 and £40k under previous UK GAAP*

The journal above would restate the lease incentive in the opening FRS 102 balance sheet to what it would have been had FRS 102 always been the financial reporting framework, with the corresponding entry being taken to retained earnings (reserves) as per paragraph 35.8 of FRS 102.

*Option 2: continue with previous UK GAAP treatment*

Company B can continue to amortise the lease incentive up to the point at which rentals revert to market rate (ie up to the end of year five). This exemption is available for leases that have been entered into prior to the date of transition to FRS 102.

**Transition to FRS 102: worked example**

The concepts in Section 35 can be fairly complicated in some situations. However, as previous UK GAAP was largely (but not always) converged to the principles found in IFRSs, some entities may find that they only have a small number of transitional and prior-year adjustments to deal with on transition (although some entities may find that they have several). An example of how to apply the concepts in section 35 is shown below using a fictitious company, Smallco Ltd:

Smallco Ltd is preparing its first set of FRS 102 financial statements for the year ended 30 April 2017. The date of transition is 1 May 2015 and the opening balance sheet position as at that date is shown below:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Smallco Ltd** |  |  |  |  |  |  |
| **Trial balance as at 1 May 2015**  |  |  |  |  |  |
|  |  |  |  | Note | Dr | Cr |
|  |  |  |  |  | £ | £ |
| Plant and machinery  |  |  |  | 104,801 |  |
| Plant and machinery depreciation  |  |  |  |  | 34,926 |
| Fixtures and fittings  |  |  |  | 308,987 |  |
| Fixtures and fittings depreciation  |  |  |  |  | 158,604 |
| Investment property  |  |  | 1 | 206,650 |  |
| Stock  |  |  |  |  | 11,383 |  |
| Trade debtors  |  |  |  |  | 650,114 |  |
| Prepayments  |  |  |  |  | 15,649 |  |
| Interest-free loan to subsidiary company  |  | 2 | 15,000 |  |
| Cash at bank and in hand  |  |  |  | 850,669 |  |
| Trade creditors  |  |  |  |  |  | 75,864 |
| Corporation tax  |  |  |  |  |  | 16,300 |
| Sundry creditors  |  |  |  |  |  | 8,546 |
| Accrued expenses  |  |  | 3 |  | 16,200 |
| Director's current account due after more than one year  | 4 |  | 65,000 |
| Deferred tax  |  |  |  |  |  | 9,164 |
| Share capital  |  |  |  |  |  | 100 |
| Revaluation reserve  |  |  |  |  | 85,200 |
| Profit and loss account reserves  |  |  |  |  | 1,693,349 |
|  |  |  |  |  | 2,163,253 | 2,163,253 |

***Notes***

1. The investment property was accounted for under the *FRSSE* (effective January 2015) and a valuation was obtained from an independent firm of chartered surveyors on 30 April 2015, which was included in the above trial balance. The investment property is to be accounted for at fair value under section 16, ‘Investment Property’. The directors do not want to recognise a separate reserve in respect of any reserves that are not distributable and the directors do not anticipate selling the investment in the foreseeable future.

2. There are no formal loan terms attached to the loan to the subsidiary company.

3. Smallco’s holiday year is not coterminous with its year end. The payroll clerk has calculated that an amount of £7,200 was due to employees at the year end in respect of accrued holiday pay. The company has previously not accounted for unpaid holiday entitlement accrued at the year end.

4. The director’s loan account represents funds introduced by the director who is also the majority shareholder of the business. The director does not consider the loan to be repayable in the foreseeable future and the loan has been classed as long-term under previous UK GAAP. There are no formal terms attached to the loan and no interest payments are made to the director.

Paragraph 35.7 says that an entity shall, in its opening statement of financial position (balance sheet) as at the date of transition:

a. recognise all assets and liabilities whose recognition is required by this FRS

b. not recognise items as assets or liabilities if this FRS does not permit such recognition

c. reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under this FRS

d. apply this FRS in measuring all recognised assets and liabilities.

The entity is required to consider its accounting policies and determine whether they are compliant with the requirements of FRS 102. Where such policies may have been permissible under previous UK GAAP, but are not permissible under FRS 102, they must be changed retrospectively to the date of transition as well as in the comparative financial statements.

In Smallco’s case, there are four matters which must be dealt with at the date of transition in order that the opening balance sheet position at the date of transition is compliant with FRS 102. These are dealt with as follows:

**1. Investment property**

The investment property was previously carried at open-market value at each balance sheet date under the *FRSSE* (effective January 2015). Gains and losses in respect of this investment property were taken to the revaluation reserve within equity and reported through the statement of total recognised gains and losses; this is because such properties were accounted for under the alternative accounting rules, which required amounts to be transferred to a revaluation reserve. The accounting treatment for such properties is different under FRS 102, because all fair value gains and losses must be reported within profit or loss. (Note: FRS 102 does not recognise the concept of ‘operating profit’ but such gains and losses should be regarded as operating gains/losses.) As the fair value accounting rules are being applied under FRS 102 to the investment property, all gains and losses are taken to profit and loss.

It is worth noting that the treatment of fair value gains and losses **only differs in respect of investment property**. Items of property, plant and equipment which are measured under the revaluation model under Section 17, ‘Property, Plant and Equipment’,are treated in the same way as previous UK GAAPand are taken to the revaluation reserve.

The transitional adjustments needed are as follows:

 £

Dr revaluation reserve 85,200

Cr profit and loss reserves 85,200

*being reallocation of revaluation reserve in respect of the investment property*

Where transitional adjustments are concerned, corresponding entries are taken to profit and loss account reserves (retained earnings) as per paragraph 35.8.

Note: an alternative treatment would be to rename the revaluation reserve ‘fair value reserve’ or ‘undistributable reserves’ to ring-fence those gains that are not available for distribution to the shareholders. There is nothing in company law that requires this treatment, but it may be advisable to have a separate reserve to take unrealised gains to prevent them from being inappropriately distributed to shareholders.

Paragraph 29.16 requires deferred tax to be brought into consideration where investment properties are concerned to comply with section 29, ‘Income Tax’.The directors do not envisage selling the investment property in the foreseeable future and paragraph 29.16 requires deferred tax in respect of investment property to be measured using the tax rates and allowances that apply to the sale of the asset. Therefore, if it is assumed the tax rate which will apply to the sale is 20%, deferred tax (excluding the effects of indexation) is recognised on the investment property at the date of transition as follows:

 £

Dr profit and loss reserves 17,040

Cr deferred tax provision 17,040

*being deferred tax on the investment property revaluation (£85,200 x 20%)*

Note: if Smallco Ltd were to recognise unrealised gains and losses in a separate reserve, the debit would have been taken to that specific reserve. The concept of ‘tax treatment follows accounting treatment’ applies in respect of deferred tax.

The net gain of £68,160 (£85,200 less £17,040) must not be distributed to shareholders because it is an unrealised gain. Gains only become realised gains when they are readily convertible into cash, and a fair value gain on investment property is not readily convertible into cash.

**2. Interest-free loan to subsidiary company**

There are no specific terms attached to the loan made to the subsidiary company. If there were terms in existence, then consideration would have to be given to the maturity date. If the loan is repayable after more than 12 months, then it would have to be accounted for using the amortised cost method under section 11, ‘Basic Financial Instruments’, which uses the effective interest method (although Smallco could use the optional exemption in paragraph 35.10(v) and not restate the comparative information to comply with the requirements of paragraph 11.13 at its transition date).

A market rate of interest would have to be established (such as the rate of interest the subsidiary company would pay for an equivalent loan from its bank), and reflect this interest credit in Smallco’s profit and loss account and as a finance cost in the subsidiary’s profit and loss account. The entries in Smallco would debit the loan receivable and credit interest income in profit and loss while the subsidiary would debit interest payable and similar expenses, and credit the loan account/accruals.

As there are no specific terms attached to this loan, the default presumption is that the loan is repayable on demand and hence it is to be treated as such in the balance sheet on transition, in the prior year and going forward. While this may not be such an issue for Smallco, if the subsidiary has classified the loan as a long-term liability, it would have to move it up to current liabilities in its balance sheet. This will reduce the value of the subsidiary’s net current assets, or turn net current assets into net current liabilities or even increase net current liabilities. This is an important planning point prior to the transition as reallocating loans from long-term to current may impact credit ratings and the views of lenders and creditors.

**3. Holiday pay accruals**

The holiday year at Smallco is not coterminous with its year end. It is not always advisable to align the holiday year with the financial year simply for financial reporting purposes, and in situations where the holiday year is not aligned to the accounting reference date, holiday pay accruals will be needed to comply with the requirements of section 28, ‘Employee Benefits’. It is also to be noted that it is possible that holiday pay *prepayments* might be recognised depending on where the entity’s holiday year is in relation to the financial year.

In the example, the payroll clerk has calculated that an amount of £7,200 was due to employees as at 30 April 2015 and that this amount had not previously been recognised. Therefore, the transitional adjustments are as follows:

 £

Dr profit and loss reserves 7,200

Cr accruals 7,200

*being holiday pay accruals as at 30 April 2015*

Tax implications have been ignored for the purposes of this example, but would be brought into account if the holiday pay accrual is paid within nine months of the year-end date (as corporation tax relief is granted in such situations).

**4. Director’s loan account**

The director (who is also the majority shareholder) has made a loan to the business amounting to £65,000.

The loan has no formal terms attached to it but has been regarded as a long-term liability in previous accounting periods. In the absence of any specific terms, this treatment is not possible under FRS 102 because loans without specific terms attached would be regarded as being repayable on demand (in much the same way as the loan discussed in Note 2 above). A transitional adjustment is needed to reflect the on demand feature of the loan as follows:

 £

Dr long-term liabilities 65,000

Cr director’s current account (current liabilities) 65,000

*being reallocation of director’s current account*

Following the incorporation of the above transitional adjustments, Smallco’s opening trial balance at the date of transition will look as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Smallco Ltd** |  |  |  |  |  |  |
| **Trial balance as at 1 May 2015**  |  |  |  |  |  |
|  |  |  |  |  | Dr | Cr |
|  |  |  |  |  | £ | £ |
| Plant and machinery  |  |  |  | 104,801 |  |
| Plant and machinery depreciation  |  |  |  |  | 34,926 |
| Fixtures and fittings  |  |  |  | 308,987 |  |
| Fixtures and fittings depreciation  |  |  |  |  | 158,604 |
| Investment property  |  |  |  | 206,650 |  |
| Stock  |  |  |  |  | 11,383 |  |
| Trade debtors  |  |  |  |  | 650,114 |  |
| Prepayments  |  |  |  |  | 15,649 |  |
| Interest-free loan to subsidiary company  |  |  | 15,000 |  |
| Cash at bank and in hand  |  |  |  | 850,669 |  |
| Trade creditors  |  |  |  |  |  | 75,864 |
| Corporation tax  |  |  |  |  |  | 16,300 |
| Director's current account due within one year  |  |  | 65,000 |
| Sundry creditors  |  |  |  |  |  | 8,546 |
| Accrued expenses  |  |  |  |  | 23,400 |
| Deferred tax  |  |  |  |  |  | 26,204 |
| Share capital  |  |  |  |  |  | 100 |
| Profit and loss account reserves  |  |  |  |  | 1,754,309 |
|  |  |  |  |  | 2,163,253 | 2,163,253 |

Profit and loss account reserves have increased by £60,960 (£1,754,309 less £1,693,349) and this increase is reconciled as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | £ |
| Profit and loss account reserves under previous UK GAAP |  | 1,693,349  |
| Reallocation of revaluation reserve for investment property  |  | 85,200  |
|  |  |  |  |  | 1,778,549  |
| Additional deferred tax recognised on investment property  |  | (17,040) |
| Holiday pay accrual  |  |  |  | (7,200) |
| Profit and loss account reserves under FRS 102  |  |  | 1,754,309  |

## Prior-year adjustments

Adjustments are made to the opening balance sheet position so that the ‘starting point’ within the first FRS 102 financial statements is compliant with the requirements of the standard. As financial statements will invariably include the previous year as comparative, those comparatives must also be restated so that they reflect the provisions in FRS 102. This will enable the financial statements to be comparable and consistent.

Continuing with the example of Smallco above, the trial balance as at 30 April 2016 prepared under previous UK GAAP is shown below:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Smallco Ltd** |  |  |  |  |  |  |
| **Trial balance as at 30 April 2016**  |  |  |  |  |  |
|  |  |  |   | Note | Dr | Cr |
|  |  |  |  | £ | £ |
| Plant and machinery  |  |  |  | 104,801  |  |
| Plant and machinery depreciation  |  |  |  |  | 52,395  |
| Fixtures and fittings  |  |  |  | 308,987  |  |
| Fixtures and fittings depreciation  |  |  |  |  | 235,851  |
| Investment property  |  |   | 1 | 226,650  |  |
| Stock  |  |  |  |  | 13,002  |  |
| Trade debtors  |  |  |  |  | 632,114  |  |
| Prepayments  |  |  |  |  | 15,649  |  |
| Interest-free loan to subsidiary company  |   | 2 | 15,000  |  |
| Cash at bank and in hand  |  |  |  | 1,861,332  |  |
| Trade creditors  |  |  |  |  |  | 71,552  |
| Corporation tax  |  |  |  |  |  | 164,664  |
| Sundry creditors  |  |  |  |  |  | 8,546  |
| Accrued expenses  |  |   | 3 |  | 23,400  |
| Director's current account due after more than one year  | 4 |  | 65,000  |
| Deferred tax  |  |  |  |  |  | 25,540  |
| Share capital  |  |  |  |  |  | 100  |
| Revaluation reserve  |  |  |  |  | 20,000  |
| Profit and loss account reserves  |  |  |  |  | 1,754,309  |
| Sales  |  |  |  |  |  | 4,126,211  |
| Opening stock  |  |  |  |  | 11,383  |  |
| Purchases |  |  |  |  | 2,574,327  |  |
| Closing stock  |  |  |  |  |  | 13,002  |
| Freight  |  |  |  |  | 351,104  |  |
| Director’s remuneration  |  |  |  | 18,012  |  |
| Employer NIC on director’s remuneration  |  |  | 1,449  |  |
| Staff salaries  |  |  |  |  | 142,604  |  |
| Advertising  |  |  |  |  | 5,692  |  |
| Travelling  |  |  |  |  | 25,214  |  |
| Accountancy and bookkeeping  |  |  |  | 8,500  |  |
| Bank charges  |  |  |  |  | 2,334  |  |
| Depreciation charges  |  |  |  | 94,716  |  |
| Tax |  |  |  |  | 147,700  |  |
|  |  |  |  |  | 6,560,570  | 6,560,570  |

Summary financial statements based on the above trial balance are as follows:

**Balance sheet**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | £ | £ |
| Fixed assets  |  | 352,192  |  |
| Current assets  |  | 2,537,097  |  |
| Liabilities  |  |  | 333,162  |
| Provisions for deferred tax  |  | 25,540  |
| Equity and reserves  |  | 2,530,587  |
|  |  | 2,889,289  | 2,889,289  |

**Profit and loss account**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  | £ |
| Turnover  |  |  | 4,126,211  |
| Cost of sales |  |  | (2,572,708) |
| Distribution costs  |  | (351,104) |
| Administrative expenses  |  | (298,521) |
| Profit before tax  |  | 903,878  |
| Tax  |  |  | (147,700) |
| Profit after tax |  |  | 756,178  |

Adjustments will have to be made to the prior-year balances so that they reflect the provisions in FRS 102 as follows:

***Notes***

**1. Investment property**

The investment property has seen a fair value gain as at 30 April 2016 of £20,000. The entries in the comparative year were:

Dr investment property £20,000

Cr revaluation reserve £20,000

A prior-year adjustment will have to be done to reflect the provisions of Section 16 in FRS 102 as follows:

Dr revaluation reserve £20,000

Cr profit and loss account £20,000

*being reallocation of revaluation gain in the year to 30 April 2016*

An additional deferred tax liability will have to be recognised on the fair value gain. If it is assumed that the rate of tax applied to the sale of the asset will be 20%, the deferred tax liability is calculated at £4,000 (£20,000 x 20%) and the prior-year adjustment will be:

Dr tax expense £4,000

Cr deferred tax provision £4,000

*being deferred tax on revaluation gain as at 30 April 2016*

**2. Interest-free loan to subsidiary**

This loan will continue to be treated as a current asset in Smallco’s balance sheet because there are no terms attached to the loan and hence it is treated as being repayable on demand. The loan in the subsidiary’s financial statements will be shown as a current liability to reflect the on demand feature of the loan.

**3. Holiday pay accrual**

The payroll clerk has calculated that an amount of £8,500 was due to the administration staff in respect of holiday pay accrued but not paid as at 30 April 2016. This is an increase of £1,300 (£7,200 less £8,500) on the holiday pay accrued at the date of transition. The prior year adjustment will therefore be:

Dr staff salaries £1,300

Cr accruals £1,300

*being increase in holiday pay accrual at 30 April 2016*

**4. Director’s loan account**

As the loan made to the director-shareholder does not have any formal loan terms attached to it, this must also be regarded as repayable on demand in the prior year’s financial statements. A prior-year adjustment must be made to reallocate the loan from long-term liabilities to current liabilities as follows:

Dr long-term liabilities £65,000

Cr current liabilities £65,000

*being reallocation of director’s current account in the prior year*

Once the above prior-year adjustments have been put through, the trial balance will be as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Smallco Ltd** |  |  |  |  |  |  |
| **Trial balance as at 30 April 2016**  |  |  |  |  |  |
|  |  |  |  |  |  Dr |  Cr |
|  |  |  |  |  |  £  |  £ |
| Plant and machinery  |  |  |  | 104,801  |  |
| Plant and machinery depreciation  |  |  |  |  | 52,395  |
| Fixtures and fittings  |  |  |  | 308,987  |  |
| Fixtures and fittings depreciation  |  |  |  |  | 235,851  |
| Investment property  |  |  |  | 226,650  |  |
| Stock  |  |  |  |  | 13,002  |  |
| Trade debtors  |  |  |  |  | 632,114  |  |
| Prepayments  |  |  |  |  | 15,649  |  |
| Interest-free loan to subsidiary company  |  |  | 15,000  |  |
| Cash at bank and in hand  |  |  |  | 1,861,332  |  |
| Trade creditors  |  |  |  |  |  | 71,552  |
| Director's current account due within one year  |  |  |  | 65,000  |
| Corporation tax  |  |  |  |  |  | 164,664  |
| Sundry creditors  |  |  |  |  |  | 8,546  |
| Accrued expenses  |  |  |  |  | 24,700  |
| Deferred tax  |  |  |  |  |  | 29,540  |
| Share capital  |  |  |  |  |  | 100  |
| Profit and loss account reserves  |  |  |  |  | 1,754,309  |
| Sales  |  |  |  |  |  | 4,126,211  |
| Opening stock  |  |  |  |  | 11,383  |  |
| Purchases |  |  |  |  | 2,574,327  |  |
| Closing stock  |  |  |  |  |  | 13,002  |
| Freight  |  |  |  |  | 351,104  |  |
| Director’s remuneration  |  |  |  | 18,012  |  |
| Employer NIC on director’s remuneration  |  |  | 1,449  |  |
| Staff salaries  |  |  |  |  | 143,904  |  |
| Fair value gain on investment property  |  |  |  |  |  | 20,000 |
| Advertising  |  |  |  |  | 5,692  |  |
| Travelling  |  |  |  |  | 25,214  |  |
| Accountancy and bookkeeping  |  |  |  | 8,500  |  |
| Bank charges  |  |  |  |  | 2,334  |  |
| Depreciation charges  |  |  |  | 94,716  |  |
| Tax |  |  |  |  | 151,700  |  |
|  |  |  |  |  | 6,565,870  | 6,565,870  |

Summary financial statements based on the above trial balance are as follows:

**Balance sheet**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | £ | £ |
| Fixed assets |  | 352,192  |  |
| Current assets  |  | 2,537,097  |  |
| Liabilities  |  |  | 334,462  |
| Provisions for deferred tax  |  | 29,540  |
| Equity and reserves  |  | 2,525,287  |
|  |  | 2,889,289  | 2,889,289  |

**Profit and loss account**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  | £ |
| Turnover  |  |  | 4,126,211  |
| Cost of sales |  |  | (2,572,708) |
| Distribution costs  |  | (351,104) |
| Administrative expenses  |  | (279,821) |
| Profit before tax  |  | 922,578  |
| Tax  |  |  | (151,700) |
| Profit after tax |  |  | 770,878  |

## Impact on prior-year profit at 30 April 2016

Profit after tax under previous UK GAAP was £756,178 and under FRS 102 is £770,878 which is an increase of £14,700, which is reconciled as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  | £ |
| Profit reported under previous UK GAAP  | 756,178  |
| Fair value gain on investment property  | 20,000  |
| Deferred tax on fair value gain on investment property | (4,000) |
| Increase in holiday pay accrual  |  | (1,300) |
| Profit reported under FRS 102  |  | 770,878  |

## Impact on previously reported equity at 30 April 2016

Previously reported equity amounted to £2,554,827 and under FRS 102 is £2,525,287 giving rise to a reduction of £29,540 which is reconciled as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  | £ |
| Equity under previous UK GAAP  |  | 2,554,827\*  |
| Holiday pay accrual to 30 April 2016  | (8,500) |
| Deferred tax on fair value gain on investment property | (21,040) |
| Equity under FRS 102  |  | 2,525,287  |

|  |  |  |
| --- | --- | --- |
| \*As per previous UK GAAP: |  | £ |
| Share capital  |  |  | 100  |
| Revaluation reserve (85,200 + 20,000) | 105,200  |
| Profit and loss account reserve  |  | 1,693,349  |
| Profit after tax under previous UK GAAP  | 756,178  |
| **Equity under previous UK GAAP** |  |  | 2,554,827  |
| Holiday pay accrual  |  | (8,500) |
| Deferred tax on investment property revaluations  | (21,040) |
| **Equity at 30 April 2016 under FRS 102**  | 2,525,287  |

# Disclosure requirements

The requirement to disclose transitional information is an encouraged disclosure in section 1A of FRS 102, and small entities are strongly advised to make the disclosures if there has been a material impact on the financial performance and position of the entity as a result of the transition to FRS 102. Where the disclosures are being made by the small entity, they should comply with the requirements of paragraphs 35.12 to 35.15, which are split into two parts: explanations and reconciliations.

## Explanations

Paragraph 35.12 requires a reporting entity to explain how the transition from its previous financial reporting framework to FRS 102 has affected its reported financial position and financial performance.

## Reconciliations

There are certain reconciliations that must be included in a first-time adopter’s financial statements to help users to understand the effect that the transition has had on the entity and must include:

a. a description of the nature of each change in accounting policy

b. a reconciliation of equity determined in accordance with its previous financial reporting framework to equity determined in accordance with FRS 102 for both of the following dates:

i the date of transition

ii the end of the latest period presented in the entity’s most recent annual financial statements determined in accordance with its previous financial reporting framework

c. a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity’s most recent annual financial statements to its profit or loss determined in accordance with FRS 102 for the same period.

Using the example of Smallco, the disclosures to comply with the above may be as follows:

**Reconciliation of equity**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  | **At 1.5.15** | **At 30.4.16** |
|  |  |  | Note | £ | £ |
| Capital and reserves (as previously stated) |  | 1,778,649  | 2,554,827  |
| Short-term compensated absences  |  | 1  | (7,200) | (8,500) |
| Deferred tax on investment property  | 2  | (17,040) | (21,040) |
| Capital and reserves (as restated)  |  |  | 1,754,409  | 2,525,287\*  |

**Reconciliation of profit or loss for the year**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Year ended** |
|  |  |  |  |  | **30.04.2016** |
|  |  |  | Note |  | £ |
| Profit for the year (as previously reported)  |  |  | 756,178  |
| Fair value gain on investment property  | 2  |  | 20,000  |
| Deferred tax on investment property  | 2  |  | (4,000) |
| Short-term compensated absences  |  | 1  |  | (1,300) |
| Profit for the year (as restated) |  |  |  | 770,878  |

**\***For clarity, this figure can be proved as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | £ |
| Capital and reserves per FRS 102 at 1 May 2015  |  |  | 1,754,409  |
| Profit for the year under FRS 102  |  |  |  | 770,878  |
| Capital and reserves at 30 April 2016  |  |  | 2,525,287  |

**Notes to the reconciliations**

*1. Short-term compensated absences*

Prior to applying FRS 102, Smallco Ltd did not make provision for holiday pay (ie holiday earned but not taken prior to the year end). FRS 102 requires the cost of short-term compensated absences to be recognised when employees render the service that increases their entitlement. Consequently, an additional accrual of £7,200 at 1 May 2015 has been made to reflect this. The additional provision at 30 April 2016 is £8,500 and the effect on profit for the year ended 30 April 2015 is an additional expense of £1,300.

**2. Investment property**

The investment property was previously accounted for under the *FRSSE* (effective January 2015),which required gains and losses on the property’s open market value to be taken to a revalue reserve in equity. The property is being measured at fair value under FRS 102 and fair value gains and losses are reported in profit or loss. FRS 102 also requires deferred tax to be accounted for on assets that are subject to revaluation. Consequently, additional deferred tax of £17,040 was recognised at 1 May 2015 to reflect the provisions of FRS 102. An additional provision for deferred tax has been recognised at 30 April 2016 amounting to £4,000. The gain on revaluation at 30 April 2016 has been reported in profit or loss and the effect on profit for the year-ended 30 April 2016 is an increase in profit of 16,000.

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