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UK GAAP Q&A Clinic

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Session overview

- UK GAAP – where are we now?
- What has changed in the FRSSE?
- What is the future of the FRSSE?
- What is the 'micro-entities' legislation?
- What effect will the micro-entities legislation have for clients?
- What are Companies House filing requirements for micro-entities?

Session overview

- What is FRS 102 and will small companies be affected?
- Are there any differences between UK GAAP now and UK GAAP from 2015? (FRS 102)

UK GAAP – where are we now?

- Currently there is a three-tier framework:
  - The FRSSE (effective April 2008);
  - Mainstream GAAP (FRSs/SSAPs/UITFs); and
  - EU-endorsed IFRS.
- Major changes currently occurring which will affect clients of all sizes (small, medium and large).
- Significant planned changes for the FRSSE (see later) with exposure drafts already issued by the FRC on FRS 102 (even though not mandatorily effective until 2015).
- FRS 102 is considered to be THE most significant change in a generation and is most definitely the ‘way forward’ for the UK and Republic of Ireland as it an IFRS-based framework.

What has changed in the FRSSE?

- Currently the version of the FRSSE in operation is effective April 2008.
- Limited amendments issued by the FRC in 2013 as a consequential effect of FRS 102 resulting in FRSSE (effective January 2015).
- FRSSE (effective January 2015) is mandatory for accounting periods commencing on/after 1 January 2015 although earlier adoption is permissible.
- Fairly inconsequential text changes within the FRSSE:
  - Removal of references to Accounting Standards Board (ASB) – substituted with Financial Reporting Council (FRC)
  - Removal of references to FRSs, SSAPs, UITFs and inclusion of references to FRS 102
  - Specific paragraphs (6.45A to 6.45C) requiring FRSSE entities to carry out impairment tests on assets

What has changed in the FRSSE?

- Notable changes which affect practitioners and companies include:
  - Capitalised goodwill/intangibles now have a maximum UEL of FIVE years (not 20 as in current FRSSE). This applies when management cannot assign a reliable UEL to the goodwill/intangible
  - Part C *Definitions* have been amended – ‘close family’ for related party purposes includes children, spouse/domestic partner and children of spouse/domestic partner
  - The term ‘key management personnel’ has been defined
  - The definition of ‘public benefit entities’ has been included

What is the future of the FRSSE?

- Future of the FRSSE is very unsteady at present.
- FRC have opened up a consultation in March 2014 asking for users' opinions as to how they perceive the 'way forward' – this is to "inform the thinking" of the FRC.
- FRC have said they are 'tentatively' planning to withdraw the FRSSE. Planned dates for withdrawal uncertain but it may be 2015/16.
- If FRSSE is withdrawn, one option is to bring all small companies under the scope of FRS 102.
- May have an FRS 102 'Light' for smaller companies thus exempting small companies from preparing group accounts, preparing a cash flow statement and following the requirements for complex financial instruments (this is only tentative at present).

What is the future of the FRSSE?

- Another option is to have another standard running alongside FRS 102 for companies currently entitled to apply the FRSSE.
- No decisions as yet as to the future of the FRSSE.
- Exposure Draft, outlining the FRC’s plans going forward, expected in June 2014.
- Comment period expected to be around three months – although it might be shorter given that FRS 102 is due to be mandatory from 1 January 2015.
- FRC did not want to make changes to small companies’ regime until FRS 102 had become established.
- EU Accounting Directive is responsible for this change of direction.
- End result? All companies in for some VERY fundamental changes!

What is the micro-entities legislation?

- The FRSSE (2008 and 2015) were amended on 29 April 2014 due to the introduction of the micro-entities (ME) legislation.
- Legislation effective for financial years ending on or after 30 September 2013 for financial statements filed with Companies House on or after 1 December 2013.
- ME Legislation affects UK companies ONLY. There is no equivalent legislation as yet in the Republic of Ireland.
- If such legislation arises, the FRSSE will be further amended.
- ME legislation allows qualifying entities to take account of significantly reduced disclosure requirements.
- Quite controversial at present – true and fair?
- Deeming provisions?

What is the micro-entities legislation?

- Qualifying criteria:
  - Turnover £632k
  - Balance sheet total £316k
  - Employees 10
- Above criteria to be met for two consecutive years (except for newly incorporated entities).
- If client qualifies as a ME in current year but fails to qualifying in subsequent year (e.g. turnover = £700,000) the client can still adopt ME legislation.
- If turnover > £632,000 in subsequent year, client must cease to be a ME – if < £632,000 the exemptions will be uninterrupted.
- New companies to pro-rate the turnover figure to decipher qualification as a ME.

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What is the micro-entities legislation?

- ME Legislation will NOT apply to:
  - Investment undertakings
  - Financial holding undertakings
  - Credit institutions
  - Insurance undertakings
  - Charities
  - Limited liability partnerships
  - Companies in Ireland

What effect will micro-entities legislation have for clients

- First and foremost – some accounting policies need consideration:
  - ME will not be able to carry assets at revaluation
  - Fixed asset investments cannot be carried at market value
  - Current asset investments cannot be measured at current cost
- Revalued assets must be restated to their values that would have been reported under depreciated historic cost (including any impairment).
- Investment properties must be restated in the same way as revalued assets and then carried under normal fixed asset rules (i.e. there will be NO fair value accounting for investment properties under ME Legislation).
- What is ‘cost’? Can a previous revaluation be ‘deemed’ cost?

What effect will micro-entities legislation have for clients?

- No!
- ME Legislation does not recognise any concept of revaluation hence only purchase/production cost can be used.
- Could prove difficult for ME to arrive at revised carrying value for assets that have been previously revalued under FRSSE.
- Where it proves to be too time-consuming or the client wants to continue reporting under revaluation for certain assets, option is to continue reporting under ‘full’ FRSSE.
- Remember – ME Legislation is OPTIONAL.
- Other issues to consider are the financial statements themselves.

What effect will micro-entities legislation have for clients?

- Profit and loss account can only be prepared under Format 2 (not Format 1) (see next slide).
- Balance sheet can be prepared using either Format 1 or Format 2 (generally Format 1 is used).
- Notes to the accounts under the ME Legislation will only comprise:
  - Guarantees and other financial commitments; and
  - Directors benefits: advances, credits and guarantees.
- No other notes required under the ME Legislation, BUT:
- If other disclosures are put in over and above the ME Legislation, requirements of the FRSSE are to be followed for those specific areas (e.g. related party disclosures/going concern disclosures).

What effect will micro-entities legislation have for clients?

Format 2 Profit and Loss Account:

A. Turnover

B. Other income

C. Cost of raw materials and consumables

D. Staff costs

E. Depreciation and other amounts written off assets

F. Other charges

G. Tax

H. Profit or loss

What effect will micro-entities legislation have for clients?

- Adoption of ME Legislation applies for accounting periods ending on/after 30 September 2013 for accounts filed on or after 1 December 2013.
- Remember – earlier adoption of this legislation is NOT permissible as it is not possible to early-adopt legislative changes.

What are Companies House filing requirements for micro-entities?

- The concept of ‘abbreviated financial statements’ does not apply to ME.
- ME can file the ‘full’ micro-entity accounts if desired (although likely to be rare in real life), OR
- The balance sheet and the notes under the balance sheet can be filed (i.e. no profit and loss account and no directors report).

What is FRS 102 and will small companies be affected?

- FRS 102 is the new UK accounting standards (UK GAAP).
- Forms part of a suite of four standards, as follows:
  - FRS 100 *Application of Financial Reporting Requirements*
  - FRS 101 *Reduced Disclosure Framework*
  - FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*
  - FRS 103 *Insurance Contracts*
- FRS 102 is then sub-divided into 'Sections', e.g.:
  - Section 1 *Scope*
  - Section 2 *Concepts and Pervasive Principles*
  - Section 3 *Financial Statement Presentation*

  and so on
- Primarily designed for medium-sized and large companies.
- Small companies have the option of reporting under FRS 102.

What is FRS 102 and will small companies be affected?

- In light of FRCs tentative plans for the FRSSE, likely all companies will be brought under the scope of FRS 102.
- This was intended in the future prior to EU Accounting Directive.
- As the FRC may withdraw FRSSE sooner than originally anticipated all accountants dealing with company accounts must now gain an awareness of FRS 102.
- AAT MIPs may want to consider notifying clients of impending changes.
- Cost impact is to be considered (especially on transition to FRS 102).

Are there any differences between old and new UK GAAP (FRS 102)?

- Quite a lot!
- Good news first: FRC always intended to report under an IFRS-based framework.
- UK GAAP is aligned to INT (as far as legislation will permit).
- FRS 102 ‘modernises’ some accounting practice in light of developments in financial reporting over the years.
- Investment properties – significant differences in how to account for fair value gains/losses (no revaluation reserve).
- Fair value gains - two considerations:
  - Distributable as a dividend?
  - Deferred tax consequences?

Are there any differences between old and new UK GAAP (FRS 102)?

- Leasing transactions – withdrawal of 90% benchmark.
- Eight indicators of a finance lease.
- Classification of finance v operating lease based on ‘risks and rewards’ of ownership (follows IAS 17 principles).
- Cash flow statement – significant presentation changes (nine headings down to three: operating/investing/financing).
- Accruals needed for short-term employee benefits accrued but not paid at year-end (holiday pay).
- More corrections under FRS 102 to prior year accounts by way of a prior-year adjustment (FRS 3 = ‘fundamental error’, FRS 102 = ‘material’).

Are there any differences between old and new UK GAAP (FRS 102)?

- Slight variations to wording in revenue section (Section 23).
- Current GAAP = *right to consideration*.
- Section 23 = *probable economic benefits will be received or receivable* and *reliable estimation*.
- HMRC not unduly concerned in its Working Paper but FRC have the power to issue Abstract if the relaxed wording/phraseology is abused.
- Deferred tax – more onerous (but could have been worse):
    - Revaluations, including investment property
    - Fair values in business combinations
    - Unremitted earnings in overseas subsidiaries/associates
- Revaluations requirement more likely to impact in UK as FRS 19 currently does not require DT on revaluations.

Are there any differences between old and new UK GAAP?

- Stock cannot be valued under LIFO (SSAP 9 permitted, but did not favour, LIFO).
- If a transaction/event not dealt with in FRS 102, management develop a policy having regard to Section 2 (i.e. policy must be **relevant** and **reliable**).
- Some terminology differences as FRS 102 uses international terminology.
- Titles of the financial statements can remain as a balance sheet, profit and loss account and cash flow statement (per paragraph 3.22).
- Traditional titles derived from Regulations hence likely will still be used.

What is the tax impact of FRS 102?

- Beyond the remit of this session, but HMRC have issued an Overview Paper
- Download this paper from:

www.hmrc.gov.uk/accounting-standards/frs102-overviewpaper.pdf

Where can I find resources on FRS 102?

- AAT has a series of monthly articles written by me in the CPD Interactive zone which can be found using:

www.aat-interactive.org.uk/cpd/archives/author/steve-collings

- Articles feature technical overviews of each section, impacts on resources (both practice and industry), the impact on profit/loss, cash flows and balance sheets.

Thank you

Any questions?

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