FRS 102 Guide

The biggest change in UK accounting for a generation – are you ready?

Hawsons Chartered Accountants **www.hawsons.co.uk**

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Sheffield: Pegasus House | 463a Glossop Road | Sheffield | S10 2QD
Doncaster: 5 Sidings Court | White Rose Way |Doncaster |DN4 5NU
Northampton: Jubilee House | 32 Duncan Close |Moulton Park | Northampton |NN3 6WL

@Hawsons

Hawsons Chartered Accountants

INTRODUCTION

FRS 102 is the biggest development in UK accounting for a generation and brings with it significant changes to how UK GAAP accounts will be prepared in the future. There are considerable accounting, commercial and tax implications that need thinking about and acting upon now.

The new standard applies to medium and large companies from 1 January 2015 small companies will come within its scope from 1 January 2016.

This practical guide looks at the significant changes that FRS 102 may bring about and how best to successfully plan for the transition.

It is intended as a useful resource to help company directors and accountants fully prepare for implementation of FRS 102.

For more information please contact our FRS 102 specialists.

Contact details can be found on page 9.

Frequently asked questions

What is FRS 102?

Important changes have been made to UK GAAP with the introduction of Financial Reporting Standard 102 (FRS 102). FRS 102 is the biggest development in UK accounting for a generation and brings with it significant changes to how UK GAAP accounts will be prepared for the future. The precise impact of FRS 102 will differ from one company to another. For some, the impact could be minimal but for many others the devil will be in the detail.

What companies are affected?

The new standard applies to medium and large companies from 1 January 2015 with small companies coming within its scope from 1 January 2016.

Can I continue to apply current UK GAAP?

No, unless you are an eligible entity applying the FRSSE. For other entities, FRS 102 replaces all existing FRSs, SSAPs and UITFs for accounting periods beginning on or after 1 January 2015. Most of the existing SORPs are being updated although some are being withdrawn when the new standards come into effect.

Is early adoption permitted?

Yes, FRS 102 can be adopted early for accounting periods ended on or after 31 December 2012. It may be that introduction of FRS 102 will bring with it significant advantages: for example, it could initially improve tax cash flows.

If you are thinking of starting a new business it may be a good idea to apply the new standards early to avoid changing frameworks within a short period of time.

Can I switch from using EU-adopted IFRS to using FRS 102?

Yes, as long as you are a company that voluntarily prepares their accounts under EU-adopted IFRS and you have not previously switched in the last five years. If you are part of a group, certain consistency criteria must also be met.

What should I do now?

It is extremely important that you start preparing for FRS 102 now, even if you are not planning on adopting early, to ensure a smooth transition to the new standard. We recommend you start planning as soon as you can.

How can Hawsons help?

Hawsons provides FRS 102 advice in our Sheffield, Doncaster and Northampton offices. Our FRS 102 specialists understand the commercial, accounting and taxation changes that the new standards may bring.

Commercial & Accounting

Reported profits could change

Companies will need to assess how the following changes will affect their reported profits and communicate this to affected stakeholders:

- changes in the recognition of certain fair value movements (e.g. investment properties);
- changes in the timing of certain gains and losses (e.g. forward exchange contracts); and
- other changes in the way certain items are recorded in profit or loss (e.g. holiday pay accruals)

The balance sheet position could be significantly affected

FRS 102 has slightly different definitions of what constitutes certain tangible and intangible assets and also changes the way certain assets and liabilities are measured. Furthermore, specific definitions for, and treatment of, financial assets and liabilities are set out for the first time.

FRS 102 requires deferred tax to be recognised on items such as the revaluation of investment properties and certain other assets. Consequently, balance sheets of affected companies could be negatively impacted through the recognition of new deferred tax liabilities.

Effect on banking covenants and other commercial and practical considerations

A change in the recognition criteria of assets and liabilities, as well as profits and losses could have an impact on the credit rating of a company. Additionally, where loan covenants are calculated based on profit or balance sheet measures, the move to FRS 102 could have an impact on the headroom of those covenants.

Where companies pay bonuses out of profit, have profit-related pay schemes, or have earn-out agreements spanning the transition date, the basis of these calculations should be reconsidered.

Also, with changes in fair value being reflected in the profit or loss for the period, companies will need to take more care when determining taxable profits and companies will need to ensure that dividends are paid out of distributable profits.

"THE PERCISE IMPACT OF FRS 102 WILL DIFFER FROM ONE COMPANY TO ANOTHER – FOR SOME, THE IMPACT COULD BE MINIMAL, BUT FOR MANY OTHERS, THE DEVIL WILL BE IN THE DETAIL"

There are opportunities on transition

Generally, on transition to FRS 102, companies are required to restate the opening comparative balance sheet. However, in some instances options are available and these options require careful consideration as the options taken could have a significant effect on the accounts.

Accounts will look different

Fundamentally, the formats of the financial statements will be similar. However, there will be some subtle, yet key differences.

The notes to the accounts will be different. In some areas new or additional disclosures are required, in other areas less will need to be disclosed. The differences in notes disclosures are far ranging so companies need to be aware of the need to retain comparative information.

Companies will need to gather more information, both at the date of transition and on an ongoing basis, for the preparation of their accounts. They will also need to consider whether their current systems and software will be sufficient to prepare accounts under FRS 102.

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Tax

The implementation of FRS 102 will have a significant impact on the accounts of many UK companies, and these changes potentially have tax implications. Below outlines some of those key areas that businesses need to be aware of.

A starting point

All tax computations use as their starting point the reported profit in the accounts, with adjustments only made for specific items as required by tax law. FRS 102 introduces a number of changes that affect profits, from changes to the calculation of accounting entries to recognising changes in values that weren't previously included in the profit and loss account. Most of these changes will have a corresponding impact on the tax charge. It is likely that overall reported profits and consequently taxable profits will be more volatile as a result of FRS 102.

Impact on profits

FRS 102 can affect reported profits in a number of ways:

- The value of some debts and financing arrangements, (technically referred to as financial instruments and derivatives), will be stated at fair value at each year end, with changes in value passing through the profit and loss account. This will include interest free loans, where the lack of interest may initially lead to the book value of the debt being written down, with subsequent increases over time until the loan is repaid. For companies the tax treatment will follow the accounts so these accounting adjustments will have a tax impact;
- When a business is purchased more separate intangible assets could be identified as assets acquired as well as goodwill, including intellectual property, customer lists and brand names. These will be amortised separately, and the existing presumptions regarding economic life and amortisation periods are changed. For example, a brand name may have a perceived useful life significantly longer than that of lists of existing customers. For companies that receive tax relief for this amortisation these changes in timing will affect the timing of tax relief;
- Software costs will now be treated as intangible assets instead of tangible assets, so tax relief will be based upon accounting amortisation rather than separate (and usually much slower) capital allowances;
- Lease incentives, such as rent-free periods, will now be spread over the full term of the lease, extending the period over which the reduced expense is recognised in the accounts and consequently spreading the resulting extra tax over a longer period;
- Holiday pay accruals will now be required, and if employees don't use all their entitlements within 9 months of the year end then tax relief will be delayed into the next accounting period;
- Biological assets (living plants and animals) can optionally be included in stock at fair value instead of cost. This may give rise to fluctuations in profit, which will flow through into the tax charge;
- Movements in investment property valuations will now be reflected, although this will not have a tax impact.

Making the change

On adoption of FRS 102 the opening balance sheet carrying values in the majority of these areas will be restated, with adjustments – which effectively represent the cumulative differences there would have been in historical profits if FRS 102 had always been in place – being taken directly to brought forward profit and loss reserves. Restatement of existing operating leases is however optional.

Generally such opening balance adjustments are brought into account as a tax adjustment in the first period of the new treatment, although there are specific alternatives for some cases arising from FRS 102 changes. The tax impact of these adjustments may be able to be spread over 10 years (loan relationships and derivatives) or 6 years (biological assets).

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"FRS 102 WILL HAVE A NUMBER OF SIGNIFICANT CHANGES IN REPORTED PROFITS. THOSE REPORTED PROFITS ARE THE STARTING POINT FOR CALCULATING TAX LIABILITIES – AND VERY OFTEN, THOSE CHANGES WILL FLOW THROUGH AND HAVE A DIRECT IMPACT ON THE TAX LIABILITY"

SUMMARY

The precise impact of FRS 102 will differ from one company to another. For some, the impact could be minimal but for many others the devil will be in the detail. We therefore recommend you start planning as soon as you can.

If you have attended one of the Hawsons FRS 102 seminars, watched our “90 second guide to videos” and read this guide then you have made a big step in terms of your preparation. However, to fully prepare for implementation of FRS 102, it is crucial that you seek further advice to ensure you completely understand FRS 102 and the impact it may bring on your particular business.

We advise seeking advice from Hawsons’ FRS 102 specialists to ensure that not only is the transition as smooth as possible, but you take advantage of the significant opportunities available. Our FRS 102 specialists understand both the commercial, accounting and taxation changes that the new standard will bring and can help you to achieve a successful transition for your company.

Hawsons provides FRS 102 advice in our Sheffield, Doncaster and Northampton offices.

Please contact your local specialist for more information.

www.hawsons.co.uk/frs102

Not yet a Hawsons client?

We offer all new customers a free initial, no-obligation consultation.

This consultation will enable you to have a detailed discussion about your business and how Hawsons can help you achieve a successful transition to the new standard.

Please contact your local office for more information.

Contact details on page 9.

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OUR FRS 102 SPECIALISTS

www.hawsons.co.uk/frs102

Chris Hill
Sheffield
Partner
0114 266 7141
cih@hawsons.co.uk

Paul Wormald
Doncaster
Partner
0114 367 262
pw@hawsons.co.uk

David Owens
Northampton
Partner
01604 645 600
davidowens@hawsons.com

David Cairns
Northampton
Tax Partner
01604 645 600
davidcairns@hawsons.com

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