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New UK GAAP – Dramatic Changes Ahead

The form and content of company accounts are changing for accounting periods beginning on or after 1st January 2015. In most instances companies will show a different bottom-line profit or loss and a different total for net assets on the balance sheet total. Very often these changes will also lead to a higher or lower tax bill.

The extent of the change will vary on a company by company basis. It will depend upon the nature of the company's activities and the types of assets which it has.

We can assist you in providing an impact assessment on your accounts.

Large and medium sized companies

For these companies, the changes result from the introduction of FRS 102 ('Financial Reporting Standard 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland'). FRS 102 replaces all existing accounting standards – other than the Financial Reporting Standard for Smaller Entities (FRSSE) (see below).

The new standard must be applied for periods commencing on or after 1st January 2015, though early adoption is possible.

Small companies

FRS 102 does not have to be followed by small companies. Instead, small companies can continue to opt for the FRSSE. However, for accounting periods commencing on or after 1st January 2015, there are some 'consequential changes' to the FRSSE. In particular this affects related party definitions, the amortisation of intangibles and impairment reviews.

To qualify as small, broadly, a company needs to satisfy two of the three criteria on an ongoing basis:

	Currently	Proposed
Turnover	£6.5m	£10.2m
Total assets	£3.26m	£5.1m
Employees	50	50

There is a proposal that the FRSSE will be replaced for periods commencing 1st January 2016. Companies which are small, but not micro will then follow FRS 102. Micro-companies will have a separate standard which the proposals indicate will have requirement or option to fair value assets and no provision for deferred tax.

We will send out a separate briefing once the changes are finalised.

The main areas in which FRS 102 will have an impact on company accounts

FRS 102, including appendices, is less than 350 pages – significantly less than the existing accounting standards contained within SSAPs and FRSs.

This briefing only draws attention to some of the most common areas which will affect a company's accounts. We can of course advise you on the specific impacts for your business in far more detail.

Taxation

One of the most important impacts will be on the tax payable on profits. Broadly tax is payable on the profits given in the accounts. Consequently, if the accounting profits increase or reduce as a result of a new accounting standard, so does the tax payable. There are certain exceptions to this – such as the change to investment property accounting described below. The changes do not affect continuing tax related issues such as capital allowances.

The changes also mean that there will be more instances where deferred tax must be provided for. For example, the deferred tax on revaluations will now be provided for rather than just appearing in a note to the accounts.

Names of the statements

For the main statements in the accounts, you will have the choice of whether to continue to use names such as 'Profit and Loss Account' and 'Balance Sheet', or to use the terms used in FRS 102. The terms used in FRS 102 are 'Income Statement' and the 'Statement of Financial Position'. Some of the detailed content within the accounts may use slightly different terminology. For example, instead of 'net realisable value' the phrase 'estimated sales proceeds less costs to complete and sell'.

Investment properties

These are properties held not for business use but to make money from, whether by rental income or by eventual sale proceeds. The definition is widened such that properties currently excluded from the definition (owner occupied investment properties and properties rented to other group companies) are no longer excluded.

As in current UK GAAP, investment properties are required to be revalued each year. However, rather than taking annual gains or losses directly to reserves on the balance sheet via the statement of recognised gains and losses (the STRGL), the gains or losses now have to be taken to the profit and loss account for the period.

Even though included in the profit for the year, these gains and losses are not realised gains or losses, are not available to pay out as dividends, and will not be taxable until the properties are actually sold.

Goodwill (and other intangibles)

This is an area where both present and new UK GAAP is complicated. The main change is in the period over which any goodwill has to be written off. In principle, goodwill should be written off over its estimated life and where that is being done already there may be no change.

At present UK GAAP states that intangibles should be written off over no more than 20 years, unless a formal impairment review is carried out. Under new UK GAAP, intangibles should be amortised over no more than 5 years, unless a longer period can be justified.

In consequence, the annual amortisation may be much larger, reducing profits significantly; and the whole goodwill may reduce reserves far sooner than at present. In some extreme circumstances this can even lead to accumulated profits becoming negative (ie accumulated losses) giving rise to the possibility that no dividend can be paid.

Financial instruments

This is the technical name for a number of items that appear in accounts such as cash, debtors, creditors, loans payable and receivable and derivatives (the collective term for forward exchange contracts, futures and interest rate swaps).

Many companies will have financial instruments where new UK GAAP requires a different treatment.

The problem with FRS 102 is that financial instruments are generally required to be revalued each year to 'Fair Value' (roughly their market value at the balance sheet date) and any profits or losses have to be taken to the profit and loss account. Some of these, but not all, will also have an impact on taxable profits. In particular, financial instruments which are to be included at their fair value include:

- investments in other companies
- forward foreign currency contracts
- exchange rate swaps
- futures.

There is also new treatment for certain loans payable and receivable (for which the effective interest rate basis needs to be applied) and financing transactions (where the present value basis should be used).

Related party disclosures

The good news here is that related party transactions can be disclosed by category without the need for the names of related parties. The bad news is that there is additional disclosure required of 'compensation of key management personnel'. This is additional to the company law requirement to disclose 'directors' remuneration'. In many instances the disclosure required by FRS 102 and the Companies Act 2006 will be the same. Where key management exist in addition to the directors, additional disclosure will be needed.

Numerous other areas including (but not limited to):

- accruing for outstanding holiday pay
- spreading of lease incentives
- changes to what are currently called tangible fixed assets (such as land and buildings) but which become property, plant and equipment
- changes in group accounts
- changes to cash flow statements.

Implementation of new UK GAAP

The first year of FRS 102 accounts

The new standard has to be used for the first period beginning on or after 1st January 2015.

For example, if a company's year end is 31 March 2015, FRS 102 must first be adopted for the period beginning 1 April 2015.

In addition to applying the new standard to the new accounting period, the figures for the comparative period will need to be recalculated to comply with the new standard.

With a period end of 31 December 2015 your company is obliged to recalculate the figures back for the period commencing 1 January 2014 and to restate the opening comparable net assets at 31 December 2013 – known as the 'date of transition'.

Some complications which arise on implementation:

Profits of the earlier periods may be increased or reduced as a result of FRS 102. The tax impact of these changes will be entered into the tax computation for the first year of using FRS 102. There is no reopening of previous year's tax computations unless errors were made.

FRS 102 allows for the possibility of certain exemptions or options to be chosen on adoption. These include the possibility of using a deemed cost at transition for items of property, plant and machinery providing greater strength on the balance sheet and avoiding the need to have a policy of revaluation on an on-going basis. We can talk these choices through with you and explain what the impact may be of any that would apply to your accounts.

In order that your first year's accounts comply with FRS 102 you are required to include certain disclosures showing the impact of the new standard.

Changes for small companies

We will write to you in more detail about the changes for small companies in a separate briefing once the current proposals for change have been finalised.

Our next briefing will explain the options and exemptions available to micro-entities which are companies that meet two out of three criteria of:

- net turnover not more than £632,000
- balance sheet total not more than £316,000, and
- average number of employees not more than 10.

We will be very pleased to discuss the impact of FRS 102 on your company and explain what will be required to be done and when it will need to be done.