Practical guide

Issues for first-time adopters of FRS 102

September 2013

What is the issue?

FRS 102, 'The financial reporting standard applicable in the UK and Republic of Ireland' is the new UK GAAP standard, replacing existing UK standards and abstracts ('old UK GAAP'). It follows the release in November 2012 of FRS 100, 'Application of financial reporting requirements', and FRS 101, 'Reduced disclosure framework'.

Entities can take immediate advantage of reduced disclosures under IFRS (FRS 101) or can adopt new UK GAAP (FRS 102). But they should consider the pros and cons of all the options before making a decision on which regime to adopt.

This practical guide considers some of the questions that you might have if you are considering adopting FRS 102. It also summarises the first-time adoption rules and looks at differences from old UK GAAP.

When do the new rules apply?

FRS 102 applies to accounting periods beginning on or after 1 January 2015. Early application is permitted for accounting periods ending on or after 31 December 2012, although there are restrictions for entities within the scope of a statement of recommended practice (SORP).

What do I need to do?

All entities reporting under UK GAAP are affected, because they will have to decide whether to apply IFRS, FRS 101, FRS 102 or, if eligible, the Financial Reporting Standard for Smaller Entities (FRSSE). The reporting options are summarised in Appendix 1.

Qualifying entities will need to consider whether they wish to use the reduced disclosure framework in FRS 101. This might be attractive to subsidiaries in IFRS groups that wish to have statutory financial statements prepared on a consistent basis with the IFRS consolidation, but with reduced disclosures. These entities might well take advantage of the early adoption provisions.

Alternatively, groups might wish to use new UK GAAP (FRS 102) for the group and its subsidiaries. FRS 102 also has reduced disclosures for qualifying entities.

When deciding whether to apply IFRS, FRS 101 or FRS 102, management will need to consider the consequences on:

- cash taxes payable;
- medium-term distributable reserves planning;
- regulatory capital;
- bank or loan covenants;
- contractual arrangements (where they are GAAP dependent in any way);
- bonus schemes;
- implications of increased disclosures where they might be commercially sensitive; and
- data and systems requirements.

Can a group use a mix of FRS 101 and FRS 102?

Under the Companies Act 2006, where a parent company prepares group accounts, its directors have to ensure that all subsidiaries in the same group apply a consistent accounting framework, either the IAS regulation or Companies Act – unless there is a good reason for not doing so. IFRS with reduced disclosures (FRS 101) and new UK GAAP (FRS 102) are both Companies Act accounts. So it will be

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possible for a group to meet the consistency requirement where some subsidiaries apply FRS 101 and others apply FRS 102.

Can adoption of new UK GAAP be staggered?

Although all UK companies must move to the new standards by 2015, the early adoption provisions allow groups to phase when each company adopts the new regime. Old UK GAAP, new UK GAAP (FRS 102) and IFRS with reduced disclosures (FRS 101) are all within the Companies Act 2006 framework. Therefore, the company law requirement for use of a consistent accounting framework will still be met, even if adoption of the new standards is staggered.

Are there disclosure exemptions under FRS 102?

Reduced disclosures are available for qualifying entities under FRS 102. Some of these require that equivalent disclosures are included in the group's publicly available consolidated financial statements in which the entity is consolidated; FRS 100 provides guidance on the meaning of 'equivalent'. The exemptions are summarised in Table 1.

Table 1 – Disclosure exemptions

Exemptions from disclosure

- Cash flow statements.
- Financial instrument disclosures. But exemption does not apply to financial institutions. Also, non-financial institutions with certain financial instruments held at fair value have to give some company law disclosures.
- Share-based payment disclosures in a subsidiary's financial statements, using equity instruments of another group entity; and in an ultimate parent's separate financial statements, using its own equity instruments.
- Key management personnel compensation (but company law disclosures for directors' remuneration still apply).
- Related party transactions entered into between two or more members of a group (for wholly-owned subsidiaries)*.

* Disclosure is not restricted to qualifying entities.

Who can use the FRS 102 disclosure exemptions?

The disclosure exemptions in FRS 102 can be used by qualifying entities. These are defined as:

"*A member of a group where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation*".

Under FRS 102, a charity is not excluded from the definition of a qualifying entity.

A 'group' is as defined in the Companies Act 2006. This means a parent and its subsidiary undertakings. So if the investee is not a subsidiary (for example, if it is an associate or a joint venture), it does not meet the definition of a qualifying entity and cannot use the reduced disclosure exemptions in FRS 102.

The disclosure exemptions for qualifying entities apply in the individual financial statements of subsidiaries (including intermediate parents) and ultimate parents that have notified their shareholders in writing and given a brief narrative summary of the disclosure exemptions adopted.

An entity that is required to prepare consolidated financial statements or that chooses to do so cannot apply the disclosure exemptions for qualifying entities in its consolidated financial statements.

Are dormant companies affected?

There is transitional relief for dormant companies applying new UK GAAP. On transition to FRS 102, a dormant company can elect to retain its accounting policies for reported assets, liabilities and equity until there is any change to those balances, or the company undertakes any new transactions.

What are the transitional rules for entities applying FRS 102?

An entity adopting FRS 102 for the first time applies the transitional arrangements set out in Section 35 of the standard.

The underlying principle is retrospective application of FRS 102's requirements, but there are some mandatory exceptions and optional exemptions from this.

The transitional rules for first-time adopters are summarised in Appendix 2.

What are the main differences from old UK GAAP?

FRS 102 is similar to old UK GAAP, but areas with significant differences include:

- Financial instruments.
- Employee benefits.
- Deferred tax.
- Goodwill and intangible assets.
- Investment property.

These are considered below.

Financial instruments

Entities not currently applying FRS 26 (that is, the UK version of IAS 39) to their financial statements will experience the most change when moving to FRS 102.

Most basic financial instruments are measured at amortised cost; complex instruments are generally measured at fair value through profit or loss. The impairment and hedging models are based on the principles in IAS 39, but are expected to be updated in the medium term to take advantage of favourable changes arising from the introduction of IFRS 9. Alternatively, entities might apply the recognition and measurement requirements of IAS 39 or IFRS 9.

Initial measurement of financial instruments varies between transaction price (excluding transaction costs) for those held at fair value through profit or loss (FVTPL), present value of future payments for financing transactions, and transaction price (including transaction costs) for those that are not held at FVTPL or financing transactions.

Derivatives and many equity investments will need to be fair valued and recognised on the balance sheet.

There are additional disclosures in FRS 102 for financial institutions.

Employee benefits

FRS 102 anticipates the change in IAS 19 to calculate interest and return on assets as a net amount by applying the discount rate to the net pension deficit/surplus. 'Expected return on assets' will no longer apply.

The accounting for group defined benefit plans differs from FRS 17. Under FRS 102, at least one entity has to apply defined benefit accounting in its individual financial statements, depending on the policy for recharging pension costs within the group.

A liability is recognised for multi-employer pension plans where there is an agreement to fund a deficit relating to past service, even if the plan is otherwise accounted for as defined contribution. Under FRS 17 there was no clear guidance in this case.

Deferred tax

Deferred tax is recognised based on a 'timing differences plus' approach (that is, the principles currently in FRS 19 rather than the IAS 12 'temporary differences' approach). The 'plus' requires recognising deferred tax on asset revaluations and on assets (except goodwill) and liabilities arising on a business combination. Deferred tax cannot be discounted.

Goodwill and intangible assets

All intangible assets, including goodwill, are assumed to have finite lives, so they have to be amortised. (Intangibles with indefinite lives are possible under old UK GAAP.) If an entity is unable to make a reliable estimate of the asset's useful life, this should not exceed five years; FRS 10 previously specified 20 years.

The definition of 'intangible assets' has changed. There could be more intangible assets recognised as part of a business combination.

Investment property

Investment property is carried at fair value through profit or loss if fair value can be measured without undue cost or effort; otherwise, it is carried at cost within 'Property, plant and equipment'. Old UK GAAP requires that fair value movements go via the statement of total recognised gains and losses.

Other significant changes

Other areas that differ from old UK GAAP include:

- Groups are exempt from consolidating subsidiaries held as part of an investment portfolio (because these are considered to be held for resale). All portfolio investments are measured at fair value through profit or loss. These subsidiaries would be consolidated under old UK GAAP.

- Sales and purchases in a foreign currency can no longer be measured at the forward contract rate.

- The cash flow statement is similar to that under IFRS, showing movements on cash and cash equivalents, and with fewer standard headings than under FRS 1. Qualifying entities are exempt.

- Lease incentives are recognised over the lease term. Under old UK GAAP, lease incentives are spread over the shorter of the lease term and the period to the first market rent review.

How does FRS 102 compare with IFRS?

FRS 102 is based on IFRS for SMEs, which is itself a simplified form of IFRS. So many areas in FRS 102 are similar to IFRS. FRS 102 has been amended for UK-specific circumstances, for instance to comply with company law or to retain some accounting policies that were available under old UK GAAP.

Comparisons of:

- old UK GAAP and new UK GAAP (FRS 102);
- old UK GAAP and IFRS; and
- IFRS and new UK GAAP (FRS 102)

are given in Appendix 3.

Where can I find other guidance on FRS 102?

Questions and answers on the new framework in the UK are available in a new publication "New UK GAAP or IFRS? - Your questions answered" (updated April 2013).

A summary of the guidance on PwC inform is available in the Topic summary on FRS 102.

An updated 'Similarities and Differences' publication "A comparison of old UK GAAP, FRS 102 and IFRS" will be published shortly.

What is the FRS 102 Reporting Impact Assessment?

Our FRS 102 Reporting Impact Assessment is a practical service that illustrates how your most recent financial statements would have been affected by a move from old UK GAAP to new UK GAAP (FRS 102). It can then be used to focus your adoption efforts and help you plan your transition away from UK GAAP. For further details visit http://www.pwc.co.uk/audit-assurance/frs-102.jhtml.

Appendix 1 – Applying the new framework

The new framework

Under FRS 100, subject to eligibility criteria, entities are able to apply one of:

IFRS

- EU-adopted IFRS (IFRS).

Companies Act

- IFRS recognition and measurement with reduced disclosures (FRS 101, the 'reduced disclosure framework' or RDF).
- FRS 102, the FRS for UK GAAP reporters ('new UK GAAP'), which is based on the IFRS for SMEs.
- FRS 102 (new UK GAAP) with reduced disclosures (RD) available in that standard.
- The Financial Reporting Standard for Smaller Entities (FRSSE).

All except IFRS (first bullet point) are within the Companies Act 2006 accounts framework. So a group can use of mixture of the last four options above and still meet the company law requirement to use a consistent accounting framework.

A summary of the reporting options is shown below.

New framework

Reporting	Can use		
Groups listed on regulated markets	EU-adopted IFRS		
Other reporters, except as below	EU-adopted IFRS	FRS 102	
Qualifying entities	or FRS 101 RDF	or FRS 102 RD	
Small companies (as defined by company law)	EU-adopted IFRS	FRS 102	FRSSE
Qualifying entities	or FRS 101 RDF	or FRS 102 RD	

The requirement to use IFRS only applies to the consolidated financial statements of entities listed on a regulated market in the EU, or if required by other legislation.

Otherwise, entities have a choice of using IFRS, FRS 101, FRS 102 (in some cases with disclosure exemptions) or, for small entities, the FRSSE.

FRS 101 is likely to be adopted by entities in groups that prepare consolidated financial statements under IFRS and that wish to prepare their subsidiaries' individual financial statements on a consistent basis (with reduced disclosures). These entities might well decide to adopt FRS 101 early to take advantage of the reduced disclosures.

Entities currently reporting under UK GAAP that are not part of IFRS groups might decide to remain on UK GAAP. Unless there is some advantage to adopting early, they might decide to wait until 2015 before adopting FRS 102.

The possibilities are summarised in "New UK GAAP – Decision tree", available on PwC inform (www.inform.pwc.com).

Appendix 2 – Transitional rules for first time adopters

General principle

For first-time adopters, the underlying principle is retrospective application of FRS 102's requirements in the opening balance sheet and all periods presented in the first financial statements prepared under the standard. But there are some mandatory exceptions and optional exemptions from retrospective application. These are summarised below.

Date of transition

For the purpose of first-time adoption, an entity's date of transition to FRS 102 is the beginning of the earliest period for which the entity presents full comparative information in its first financial statements that comply with the FRS. [FRS 102 para 35.6].

For entities adopting FRS 102 when it is mandatory, that is for accounting periods beginning on or after 1 January 2015, and assuming that one year's comparatives are given, the relevant dates of transition are shown below:

First FRS 102 financial statements for year ending	**Date of transition**
31 Dec 2015	1 Jan 2014
31 Mar 2016	1 Apr 2014
30 Jun 2016	1 Jul 2014
30 Sept 2016	1 Oct 2014

An entity adopting FRS 102 early, say for year ended 31 December 2013, and giving one year's comparatives, will have a date of transition of 1 January 2012.

Recognition and measurement

The general principles on first-time adoption are:

- Recognise all assets and liabilities whose recognition is required by the FRS.
- Not recognise items as assets or liabilities if the FRS does not permit such recognition.
- Reclassify items recognised under the previous financial reporting framework as one type of asset, liability or component of equity, but which are a different type of asset, liability or component of equity under the FRS.
- Apply the FRS in measuring all recognised assets and liabilities.

[FRS 102 para 35.7].

The opening balance sheet (that is, the balance sheet at the date of transition) is not required to be presented. [FRS 102 para 35.7].

The accounting policies that an entity uses in its opening balance sheet under FRS 102 might differ from those that it used under its previous financial reporting framework. The resulting adjustments are recognised directly in retained earnings (or, if appropriate, another category of equity) at the date of transition. [FRS 102 para 35.8].

Exceptions to retrospective application

Paragraph 35.9 of FRS 102 says that on first-time adoption of the FRS, an entity should not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

Mandatory exceptions from full retrospective application

- Financial assets and liabilities de-recognised before the date of transition.
- Hedging relationships that no longer exist at the date of transition.
- Estimates – hindsight cannot be used to improve these.
- Discontinued operations – previous accounting is not changed.
- Non-controlling interests – generally these are not changed on transition.

Exemptions from full retrospective application

Paragraph 35.10 of FRS 102 lists a number of exemptions that a first-time adopter might use in preparing its financial statements. Any, all or none of these exemptions might be taken. They are summarised below:

Optional exemptions from full retrospective application

- Business combinations prior to the date of transition, or if an entity chooses to apply FRS 102 to a combination prior to that date, exemption applies to all combinations prior to that one.
- Similar exemption for public benefit entity combinations.
- Equity share-based payment transactions granted (or liability share-based payment transactions settled) before the date of transition. But a first-time adopter previously applying FRS 20 or IFRS 2 can apply either those standards (as applicable) or Section 26 of FRS 102 for equity share-based payment transactions at the date of transition.
- Tangible fixed assets, investment properties and a limited number of intangible assets can be recognised at:
  - fair value as deemed cost; or
  - revaluation as deemed cost.
- Investments in subsidiaries, jointly controlled entities and associates in individual and separate financial statements.
- Compound financial instruments where the liability component has been settled by the date of transition.
- Accounting by operators for service concession arrangements entered into before the date of transition.
- Measurement of oil and gas assets at the date of transition.
- Arrangements containing a lease existing at the date of transition.
- Decommissioning liabilities included in the cost of property, plant and equipment.
- Dormant companies can retain their previous accounting policies until there is any change to balances or the company undertakes new transactions.
- Deferred development costs can be carried at deemed cost.
- Borrowing costs – the date of transition can be treated as the date on which capitalisation commences.
- Lease incentives for leases that commenced before the date of transition.
- Assets and liabilities of individual subsidiaries, jointly controlled entities and associates whose transition date is different to the parent/group.
- Designation of previously recognised debt instruments.

Business combinations, including group reconstructions

A first-time adopter can elect not to apply Section 19 of FRS 102 to business combinations effected before the date of transition to the FRS. But if a first-time adopter restates any business combination to comply with Section 19, it has to restate all later business combinations.

If a first-time adopter does not apply Section 19 retrospectively, it still has to recognise and measure assets and liabilities relating to past business combinations in accordance with FRS 102 (subject to the exceptions and exemptions in Section 35) at the date of transition, except that:

- intangible assets subsumed within goodwill are not separately recognised; and
- no adjustment is made to the carrying value of goodwill.

[FRS 102 para 35.10(a)].

This means that even if an entity uses the business combination exemption, it may have to restate deferred tax arising on business combinations prior to the date of transition to FRS 102, for example on fixed assets revalued to fair value on acquisition.

Any adjustments made in recognising and measuring the assets and liabilities relating to past business combinations are made against opening retained earnings on transition to FRS 102, as goodwill cannot be adjusted. This means that where a company has acquired an unincorporated business in a trade and asset deal, adjustments (for example for deferred tax liabilities) will impact distributable profits.

If an entity previously determined that goodwill had an indefinite useful life, it will need to reassess this on transition. FRS 102 does not permit goodwill to have an indefinite useful life. So, on transition to FRS 102 entities that previously did not amortise goodwill will need to determine its remaining useful life, and subsequently amortise the goodwill over that period.

Impracticable exemption

If it is impracticable for an entity to restate the opening balance sheet at the date of transition for one or more of the adjustments required by Section 35 of FRS 102, the entity makes the adjustments in the earliest period for which it is practicable to do so. Applying a requirement is impracticable "*when the entity cannot apply it after making every reasonable effort to do so*". The entity should identify the data presented for prior periods that are not comparable with data for the period in which it prepares its first FRS 102 financial statements. [FRS 102 para 35.11].

Disclosures

An entity should explain how the transition from its previous financial reporting framework to FRS 102 affected its reported financial position and financial performance. To do this, an entity's first financial statements prepared using FRS 102 should include:

- A description of the nature of each change in accounting policy.
- Reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with FRS 102 for both of the following dates:
  - the date of transition to FRS 102; and
  - 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.
- 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.

[FRS 102 paras 35.12, 35.13].

An entity that is preparing its first FRS 102 financial statements for the year to 31 December 2015, with one year of comparative information, will disclose reconciliations for: equity (that is, net assets) at 1 January 2014 and 31 December 2014; and profit for the year to 31 December 2014.

If an entity becomes aware of errors made under its previous financial reporting framework, the reconciliations required by FRS 102 should, to the extent practicable, distinguish the correction of those errors from changes in accounting policies. [FRS 102 para 35.14].

Appendix 3 – Summary of key GAAP differences

Subject	Old UK GAAP vs New UK GAAP (FRS 102)		Old UK GAAP vs IFRS		IFRS vs New UK GAAP (FRS 102)	
Financial statements presentation	1	Companies Act formats apply for both.	2	Companies Act formats differ from IAS 1 formats.	2	IAS 1 formats differ from Companies Act formats used in FRS 102.
Cash flow statements	3	Cash vs Cash and cash equivalents. Also, FRS 102 has fewer headings.	3	Cash vs Cash and cash equivalents. Also, IFRS has fewer headings.	1	Both prepared for cash and cash equivalents. Similar headings.
Financial assets and liabilities: – FRS 4 model	3	Fair values (for example, for derivatives) not used under FRS 4.	3	Fair values not used under FRS 4. IAS 39 has detailed rules.	n/a	
– FRS 26/IAS 39 model	2	Classification of financial assets and initial measurement of basic instruments may differ. Also, different rules for hedge accounting.	1	FRS 26 is based on IAS 39.	2	Classification of financial assets and initial measurement of basic instruments may differ. Also, different rules for hedge accounting.
Foreign currency (SSAP 20)	2	Contracted rates can be used under SSAP 20.	2	Contracted rates can be used under SSAP 20. Also, no recycling.	n/a	
Foreign currency (FRS 23)	1		1	FRS 23 is based on IAS 21.	1	
Hyperinflation	1		1	FRS 24 is based on IAS 29. UITF 9 permitted a choice of methods.	1	
Revenue recognition	1		1		1	
Government grants	2	Policy choice (accruals/ performance method) under FRS 102.	1	Both use the accruals model.	2	Policy choice (accruals/performance method) under FRS 102.
Capitalisation of borrowing costs	2	Policy choice under FRS 102.	1	Capitalisation required under both.	2	Policy choice under FRS 102.
Retirement benefits	2	Net interest cost approach and group schemes differ.	2	Net interest cost approach and group schemes differ.	1	FRS 102 is similar to IAS 19 (revised).
Other employee benefits	3	No standard under old UK GAAP.	3	No standard under old UK GAAP.	1	
Share-based payment transactions	2	Option pricing models not always applied under FRS 102.	1	FRS 20 is based on IFRS 2.	2	Option pricing models not always applied under FRS 102.
Income taxes – Current	1		1		1	
– Deferred	2	More deferred tax under FRS 102 'timing differences plus' approach.	3	Timing difference vs temporary difference approaches.	2	May be less deferred tax under FRS 102 'timing differences plus' approach.
Intangible assets other than goodwill	2	More intangibles under FRS 102 and no indefinite life.	2	More intangibles under IFRS.	2	IFRS can have indefinite-lived intangibles.
Property, plant and equipment	1		1		1	
Investment property	2	Fair value movement in statement of total recognised gains and losses (old UK GAAP) vs profit or loss (FRS 102).	2	Fair value movement in statement of total recognised gains and losses (old UK GAAP) vs profit or loss (IFRS).	1	Fair value movement in profit or loss for both.
Impairment of non-financial assets	2	Annual impairment testing required for some goodwill and intangibles under old	2	Allocation and reversal of impairment	2	Impairments of goodwill can be reversed under

		UK GAAP.		losses differ.		FRS 102; they are permanent under IFRS.
Leases	2	Guidance more detailed in old UK GAAP. No 90% test in FRS 102.	2	Different methods for lessor accounting.	1	
Inventories	1		1		1	
Provisions and contingencies	1		1		1	
Events after the reporting period	1		1	FRS 21 is based on IAS 10.	1	
Consolidation	2	Subsidiaries held in investment portfolios are not consolidated under FRS 102.	2	No remeasurement of pre-existing or retained stakes under old UK GAAP. Investment entities are not consolidated under IFRS.	2	No remeasurement of pre-existing or retained stakes under FRS 102.
Business combinations (including goodwill)	2	Goodwill has to be amortised under FRS 102. Useful life is 'presumed' to be five years rather than 20 years .	2	Goodwill is not amortised under IFRS. Accounting for transaction costs and contingent consideration differs under IFRS.	2	Goodwill is not amortised under IFRS. Accounting for transaction costs and contingent consideration differs under IFRS.
Discontinued operations and assets held for sale	2	Different definitions for discontinued operations.	3	FRS 3 differs from IFRS 5.	2	FRS 102 does not deal with assets held for sale.
Investments in associates	1		1		1	
Investments in joint ventures (IAS 31)	1		3	Proportional consolidation (for joint ventures that are entities) can be used under IAS 31.	3	Proportional consolidation can be used under IAS 31.
Investments in joint ventures (IFRS 11)	1		1		1	
Related-party transactions	1	Similar definitions and disclosures.	1	Similar definitions and disclosures.	1	Similar definitions and disclosures.
Specialised activities (agriculture)	2	Cost or fair value policy choice under FRS 102. No specific guidance under old UK GAAP.	3	No fair value standard under old UK GAAP.	2	Cost or fair value policy choice under FRS 102. IFRS requires fair values.
Service concession arrangements	3	FRS 102 includes an intangible asset model for operators.	3	Old UK GAAP covers accounting by grantors. IFRS includes an intangible asset model for operators.	2	FRS 102 covers accounting by grantors.

Key:

1	Same or minor differences
2	Some differences
3	Significant differences

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