

FRS 102 – Summary of Changes

On 14 March 2013 the FRC published FRS 102 – The Financial Reporting Standard applicable in the UK and Ireland. The revised accounting standard will apply to all medium and large entity financial statements for accounting periods commencing on or after 1 January 2015, unless the entity has adopted EU endorsed IFRS. The FRS is based on IFRSs but allows some accounting policy options that exist under current UK GAAP.

The adoption of FRS 102 will affect all entities. The nature and extent of this will depend on the entity's activities and current accounting policies. With an increase in the use of fair value accounting, all entities should keep records of their distributable reserves to ensure any dividends paid in the future are lawful.

The changes which are hitting the headlines include:

Investment properties

- The definition of investment properties has been changed. Properties let to other group members will be treated as investment properties in the owner's own accounts but treated as owner occupied in the consolidated accounts
- The definition will enable properties acquired under finance leases to be treated as investment properties as long as they are held by the lessee for rentals, capital appreciation or both
- Gains on revaluation and sales of investment properties will be recognised in the profit and loss account, rather than in the statement of total recognised gains and losses
- All losses on investment properties will be recognised in the profit and loss account. The distinction between temporary and permanent diminutions in value will be removed
- There is no requirement in FRS 102 to have investment properties valued by an external valuer
- Investment properties should be restated to their fair value at each reporting date, ending the practice for entities with lots of investment properties to value these throughout the accounting period
- The significant assumptions and methods used to determine the investment properties' fair value must be disclosed

Financial instruments

- These will be classified as either "basic" or "other"
- Entities can choose to apply FRS 102 in full or adopt the recognition and measurement provisions of EU-endorsed IFRSs
- Entities should follow the disclosure requirements of FRS 102, irrespective of whether they have adopted FRS 102 or IFRS to recognise and measure their financial instruments
- Basic financial instruments are recognised at their amortised cost. Other financial instruments are included at their fair value, with changes in their value being recognised in the profit and loss account
- Hedge accounting will be introduced for the first time in UK GAAP
- Additional disclosures will be required
- Provisions may change before FRS 102 is adopted – it will depend on whether IFRS 9 – the new international standard on financial instruments – is completed by the end of this year

Cash flow statement

- This will reconcile to cash and cash equivalents. UK GAAP currently reconciles to cash
- Items currently classified as liquid resources are likely to be reclassified as cash equivalents

- Cash flows will be classified as operating, investing and financing rather than the current eight categories
- The requirement to disclose significant non-cash transactions remains

Intangible assets

- For intangible assets which are part of an active market, entities can choose whether to account for these using the amortised cost or the revaluation model. Gains and losses on revaluation are recognised in other comprehensive income. Losses in excess of gains previously recognised must be recognised in the profit and loss account. The revaluation reserve cannot be a debit figure in the balance sheet
- Intangible assets which are not part of an active market must be accounted for using the amortised cost model
- When a reliable estimate of the useful economic life of an asset cannot be made, the useful economic life used for amortisation must not exceed 5 years. The current default 20 year period for amortising goodwill that many of our clients have adopted will need to be reconsidered

Leases

- The current threshold used to test whether, at inception of the lease, the present value of the minimum lease payments amounts to at least 90% of the fair value of the leased asset is removed. The revised standard does not specify what threshold “substantially all” of the present value of minimum lease payments to the asset’s fair value is, enabling more leases to be classified as finance leases
- The disclosure requirements for finance leases (whether as a lessor or lessee) includes a general description of significant leasing arrangements including information about contingent rent, renewal or purchase obligation, escalation clauses, subleases and restrictions imposed by lease arrangements
- The disclosure of future operating commitments for lessees with operating leases becomes the total future minimum lease payments for non-cancellable leases rather than the current disclosure which is the payment committed to be made in the next year. The new standard does not require the commitment disclosure to be split into land and buildings and other operating leases
- The operating lease payments recognised as an expense are required to be disclosed under the new standard but entities will no longer need to separate these out into plant and machinery and other operating leases
- Lessors providing operating leases will be required to disclose a general description of the lessor’s significant leasing arrangements, such as contingent rent, renewal or purchase options etc but a lessee is not required to include this disclosure in their financial statements under the new standard

Holiday and other benefits’ pay accrual

- Many entities allow their employees to carry forward unused holiday and other leave entitlements, such as duvet days, from one year to the next. These “accumulated compensated absences” are required to be provided for within the financial statements as the employees work and increase their entitlement. At present, most companies will not include any provisions for carried forward holiday entitlement, carried forward sick leave etc
- The provision is calculated using the undiscounted additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period
- A prior period adjustment will be required when FRS 102 is adopted if the accrual or expense is material

Prior period adjustments

- FRS 3 enables entities to account for changes in accounting policies and the correction of fundamental errors retrospectively
- FRS 102 relaxes this rule to enable entities to account for changes in accounting policies and the correction of material prior periods errors retrospectively
- Therefore there will be more prior period adjustments under FRS 102

Related party disclosures

FRS 8 Related Party Disclosures

FRS 8 has been superseded by FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland for accounting periods beginning on or after 1 January 2015

Synopsis:

- FRS 8 defines a related party to include an entity's subsidiaries, associates, joint venture interests, directors and close family members of directors
- The standard requires an entity's transactions with related parties, regardless of whether a price is charged, to be disclosed in that entity's financial statements

FRS 102 Related party disclosures

S33 of the 2013 Financial Reporting Standard (FRS) 102 which applies in the UK and N Ireland deals with related party disclosures. The definition from s33 of FRS 102 is provided below, with an explanation following it:

“A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity).

(a) A person or close member of that person's family is related to a reporting entity if that person:

- (i) has control or joint control over the reporting entity;
- (ii) has significant influence over the reporting entity;
- (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity....”

The persons identified above may have significant influence or be a manager of the company to which the reporting entity is related. The definition goes on to describe what is meant by an 'entity' (e.g., an organisation or company, but not a person) related to the reporting entity. This includes: subsidiary companies, associate or joint venture companies.

S33.8 of FRS102 defines a related party transaction as 'a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged'. The definition of related parties under FRS 102 is the same as that used in FRS 8. FRS 8 aligned definitions with international standards a number of years ago. However, the disclosure requirements have changed significantly.

- Key management personnel compensation is required to be disclosed in aggregate. The key management of the entity is likely to encompass a larger number of individuals than the current directors/trustees
- Materiality for related party disclosures will be measured from the entity's viewpoint, rather than the current requirement to consider materiality from both the entity and related party's view
- The exemption in FRS 8 from providing disclosure of emoluments in respect of services as an employee does not exist in FRS 102. The salary and benefits paid to close family members (such as sons, daughters) of key management personnel will have to be disclosed. This information is likely to qualify for aggregated disclosure
- The disclosure exemption of pension contributions paid to a pension scheme included within current UK GAAP has not been replicated in FRS 102
- Disclosure of other related party transactions will be done by category:
 - Entities with control, joint control or significant influence over the entity

- Entities over which the entity has control, joint control or significant influence,
- Key management personnel of the entity or its parent
- Other related parties

FRS 102 requires disclosure of the nature of the relationship, as well as information about the transactions. As a minimum this will include:

- The amount of the transaction
- The amount of outstanding balances and their terms and conditions, including if they are secured and the nature of the security details of guarantees given or received
- Bad debt provisions relating to the amount of outstanding balances
- The expense recognised during the period in respect of bad or doubtful debts due from related parties

The above is likely to lead to a greater level of “discussion” between an auditor and a client as disclosures of items of a similar nature can be aggregated except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements.

Companies should note that additional information, by director and naming the individual involved, will be required when the company has provided advances, credits and guarantees to a director to ensure the financial statements comply with Company Law.

Business Combinations

- Acquisition accounting will be used for all business combinations except group reconstructions and qualifying public benefit entity combinations, when merger accounting can be used
- Negative goodwill on an acquisition will be recognised in the profit and loss account immediately. Current generally accepted practice is to recognise a negative asset and amortise this over the period that the benefit is expected to last
- A wider range of accounting treatments will be available for subsidiaries held exclusively with a view to subsequent resale and excluded from consolidation. Current UK GAAP would require these to be held at the lower of cost and net realisable value. FRS 102 enables these investments to be held as follows:
 - If held as part of an investment portfolio, the investment is held at fair value with changes recognised in the profit or loss, or
 - Either:
 - Cost less impairment
 - Fair value with changes recognised in other comprehensive income
 - Fair value with changes recognised in profit or loss
 - The entity must apply the same accounting policy for all investments in a single category
- The entity will have 12 months after the acquisition date (which is defined as the date on which the acquirer obtained control of the acquiree) to obtain the fair values of the acquiree’s assets and liabilities. Current UK GAAP requires that this exercise is completed at the end of the reporting period following acquisition, a potential difference of 11 months to complete the exercise
- When a parent increases or decreases its stake in a subsidiary but does not lose control, this transaction will be treated as a transaction between equity holders within the financial statements. Goodwill will not be recalculated for an increase in the owner’s stake and no profit or loss is recognised in the profit and loss statement for the partial disposal, which are the required current UK GAAP treatments for a change in the ownership stake. Under FRS 102, the transaction will be recognised exclusively within reserves

Agriculture

- FRS 102 introduces accounting rules for the agriculture sector – there are no current UK GAAP requirements
- Businesses can choose to adopt either the fair value model or the cost model for each class of its biological assets and related agricultural produce
- If an entity has chosen to adopt the fair value model for a class of assets, it cannot subsequently change to the cost model
- The disclosures required by the fair value model and the cost model differ

The standard can be downloaded from:

<http://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicabl.aspx>