Changing track

Accounting standards are changing and ***Lisa Weaver*** provides an overview of FRS 102 and its effects.

FURTHER INFORMATION

We plan to include an article by Nigel Davies, Charity Commission, on the impact of the accounting changes on the charity SORP in a forthcoming issue of *Financial Accountant*.

TEN SECOND SUMMARY

1. **The reporting burden may be reduced under FRS 102.**
2. **A summary of the main areas of impact of the new standard.**
3. **Starting dates and transferring to the new accounting practice.**

As discussed in Laura Kaye Tomlinson's article "The knock-on effect" (*Financial Accountant*, March/April 2014, page 22), over the next 12 months accountants must prepare themselves and their clients for a fundamental change in the way companies and other reporting entities report their financial results.

From 1 January 2015, most companies and other reporting entities in the UK and the Republic of Ireland (RoI) will be faced with reporting their financial information under a brand new financial reporting regime. Almost all of our existing generally accepted accounting practice (GAAP) will be replaced by three new financial reporting standards: FRS 100, FRS 101 and FRS 102. The Financial Reporting Council is also reviewing the financial reporting standard for smaller entities (FRSSE), and expects to issue revised accounting requirements for small entities to align with the new EU accounting directive on micro-entities (see EU Directive 2012/6/EU).

Although there is some choice for reporting entities, it is expected that the majority of non-small entities will be moving to follow FRS 102: *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. This standard represents the new UK and Irish GAAP and, in effect, replaces all previous accounting standards.

Focus on FRS 102

It is important to note that FRS 102 is not the same as previous UK and RoI GAAP standards, nor is it the same as the IFRS for SMEs. In a way, FRS 102 is a compromise between the two in that it retains many features of previous UK GAAP, but also aligns in other ways to IFRS rules and principles.

The standard is user-friendly and many of the accounting issues are simplified, making it an attractive option for companies because it should reduce the burden of financial reporting.

FRS 102 has the same overall objective of the international financial reporting standard (IFRS) for SMEs in that both aim to deliver a concise set of financial reporting rules that are relevant to the needs of non-listed reporting entities.

FRS 102 can be used by any reporting entity other than those required by law to use EU-adopted IFRS. It also contains requirements and guidance specific to public benefit entities, which are denoted by the prefix "PBE" before the relevant paragraph number. It is considerably smaller in volume than previous UK and RoI GAAP, at just over 300 pages compared to about 2,400 pages of previous SSAPs, FRSs and related documents. Indeed, the standard itself states that it aims to provide entities with succinct financial reporting requirements. The FRC stresses that FRS 102 contains proportionate disclosure requirements. The standard is organised topic by topic and is easy to follow.

The disclosure requirements of FRS 102 are generally less onerous than those of IFRS or of previous UK and RoI GAAP. The standard also contains exemptions from certain disclosures for qualifying entities adopting it.

The choice

For entities other than those required by law to use EU-adopted IFRS in the preparation of financial statements, there are important choices to be made in deciding which part of the new regime to adopt. In particular, small companies are most likely to choose between following the FRSSE (assuming it will continue to exist following the FRC's review) or to move to FRS 102.

Companies that are group members and meet the definition of a qualifying entity will be choosing between FRS 101 and FRS 102 and, in making that choice, also deciding whether to take advantage of the reduced disclosure exemptions that are available.

Some of the matters that companies may like to consider in making these choices include the following.

- *Cost and effort*. For many companies this will be a key consideration. It is simply easier and cheaper to stick with the most familiar set of rules. For example, small companies currently using the FRSSE will find the easiest option to remain with the FRSSE. Larger companies should consider making the most of the disclosure exemptions of FRS 101 or FRS 102 to ease the burden of financial reporting.

- *Impact on reported profit*. Companies should carefully evaluate the effect on profit of the various options available. The most notable differences will arise in a comparison of IFRS as implemented in FRS 101, and FRS 102 which retains many features of legacy GAAP. The level of reported profit will be a key concern for a variety of reasons in different situations, for example, a change in reported profit may effect performance related remuneration or company valuation.
- *Ability to pay a dividend*. Changes in accounting treatment and the adjustments made on transition to the new rules may impact on the level of distributable profits and therefore the ability to make dividend payments. This will clearly be a key concern for shareholders.
- *Tax implications*. Differences in accounting policies could impact on tax liabilities and also have deferred tax implications. The FRC is working with HMRC to ensure that impacts are identified and that the transition to the new regime will be as smooth as possible from a tax point of view.
- *Group accounting policies*. In a group, consolidation will be easier and less prone to risk of misstatement when group members follow broadly the same accounting policies. A key consideration therefore in a group is how to align accounting policies as far as possible.

Whatever the outcome of evaluating the options available, it is wise to consider the bigger picture and the longer term. A short-sighted decision on which standard to follow, based on assessments of impacts on tax and the ability to pay a dividend, may not be best choice in the long run. If transition matters are properly planned for, and communicated to the appropriate audience, then shorter-term tax and legal consequences are likely to be less important than matters such as achieving consistency in accounting practices across a group.

The changeover

Regarding start dates and transitional periods, FRS 100, FRS 101 and FRS 102 all have an effective date of accounting periods beginning on or after 1 January 2015. Thus, for many companies the first annual financial statements that must be prepared under the new regime will be for the year end 31 December 2015. Early adoption is permitted for FRS 100 and FRS 101. FRS 102 can also be adopted early, but only from accounting periods ending on or after 31 December 2012 and early adoption must be disclosed.

This means that reporting entities cannot continue to use the old SSAPs and FRSs, which will be withdrawn. All reporting entities much switch to the new regime for accounting periods beginning on or after 1 January 2015 at the latest.

Section 35 of FRS 102 deals with first time adoption, and the requirements apply when a reporting entity adopts it for the first time, irrespective of which financial reporting standards were previously followed.

The date of transition to the new standard is the beginning of the earliest period for which the entity presents full comparative information in accordance with it. Therefore for entities preparing their first FRS 102 financial statements to the year ending 31 December 2015, the date of transition is 1 January 2014.

Comparative information must be restated to comply with FRS 102, and disclosures must be made to reconcile figures previously reported under the SSAPs and FRSs to the restated figures.

Making the transition

The switch from “old” to “new” GAAP must be well thought-out, and its implications understood. There are areas of technical difference between the old and the new financial reporting rules, and all accountants should be aware of the major differences and how they may impact on financial performance and position. There is new terminology to get to grips with, changes in the recognition and measurement of assets, liabilities and items of income and expense that need to be understood, as well as new disclosure requirements.

It is easy to think that only those involved with accounting and finance need to get involved or will be affected by these changes. However, the lessons learned by the EU’s listed companies in their conversion to IFRS indicate that a much broader perspective is needed, and that the conversion must be treated as a project to be carefully planned and executed, and which has many consequences beyond just those relating to accounting and finance.

Lisa Weaver FCA is an author and commentator on financial reporting and governance issues. She is a teaching fellow at Aston Business School and has written a number of online courses including “Understanding the new UK and Ireland GAAP”, “Getting to grips with FRS 102”, and “Managing the Transition to new UK GAAP .”
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