Cutting through UK GAAP
Foreword

In late 2012 and early 2013 the Financial Reporting Council issued a suite of standards that replace existing UK accounting standards. Their release represents the culmination of ten years’ consultation on how best to bring UK GAAP up to date. The principal challenges in that period have been to maintain consistency with the requirements of UK law and to achieve proportionality with the needs of the users of financial statements.

Entities that are currently required to apply EU-IFRS by applicable law and regulation will continue to do so. Other entities will be able, subject to eligibility, to choose to prepare their financial statements in accordance with EU-IFRS, FRS 101, FRS 102 or the FRSSE. For subsidiaries of entities preparing EU-IFRS consolidated financial statements, the application of FRS 101 in particular will allow the use of accounting policies that are more consistent with those of the group, without the perceived burden of applying the full disclosure requirements of EU-IFRS. Groups can elect for some of their subsidiaries to apply FRS 101 and others FRS 102 (or, if eligible, the FRSSE), since both will be ‘Companies Act accounts’.

Those charged with governance will need to make important decisions about which accounting framework to apply. This will require not only consideration of the available accounting options, but also assessment of the potential effect on accounting systems, staff training, taxation and other arrangements such as loan covenants. They will also need to consider the potential effect on distributable profits. Some may wish to adopt the new standards before the mandatory effective date of periods commencing on or after 1 January 2015. Early adoption is indeed permitted but may require careful consideration of the relative merits of each of the available standards.

In this publication, we summarise the requirements of each of the new standards FRSs 100, 101 and 102. In addition, we highlight the key accounting differences between FRS 102, previous UK GAAP and EU-IFRS, in order to inform those deciding which standards to apply and to ease the transition to FRS 102 for those that choose to apply that standard.

As FRS 102 is a new financial reporting framework, common practice and interpretation has yet to develop in those areas in which the standard is not explicit in its requirements. We will update future editions of this publication to reflect that body of experience as it develops, which may be influenced both by past UK GAAP practice and evolving IFRS application.

A new GAAP, applicable to tens of thousands of entities all at once, is an exciting and challenging prospect. This new GAAP has been ten years in gestation and allows rather less time for entities to understand it. We look forward to helping you to do just that, beginning with this publication.

Tony Cates
Head of Audit, KPMG in the UK

April 2013
Interpretative guidance is based on specific facts and circumstances. In many instances, further interpretation will be needed in order for an entity to apply FRSs 100, 101 and 102 to its own facts, circumstances and individual transactions. Further, some of the information contained in this publication is based on the interpretations of KPMG in the UK’s Department of Professional Practice, that may change as practice and implementation guidance develop. Users are cautioned to read this publication in conjunction with the actual text of the standards and implementation guidance issued, and to consult their professional advisers before concluding on accounting treatments for their own transactions.
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## Appendices

- Appendix I: List of standards and interpretations referred to in this publication
- Appendix II: Common profit and loss account and balance sheet formats from Schedules 1 and 6 to the Regulations

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About this publication

This publication summarises the requirements of FRS 100, FRS 101 and FRS 102 and notes the main differences between FRS 102, previous UK GAAP and EU-IFRS. It does not consider the FRSSE and does not discuss the disclosure requirements of FRS 102 in any detail.

Although it includes an overview of the requirements of FRSs 100-102, this publication is an interpretative guide to those FRSs that builds on the standards and should be read alongside them.

The publication is organised into chapters that generally correspond to the relevant section of FRS 102 (Chapters 3 to 35). Chapters 1 and 2 consider FRS 100 and FRS 101 respectively.

This publication includes the following paragraph/section references:

- x.x (e.g. 3.1) – paragraph of the main body in this publication
- pUKx.x (e.g. pUK3.1) – paragraph of comparison to previous UK GAAP in this publication
- IFRSx.x (e.g. IFRS3.1) – paragraph of comparison to EU-IFRS in this publication
- FRS10x.x.x (e.g. FRS102.3.1) – paragraph of the relevant standard
- FRS10x.ACA.xx (e.g. FRS102.ACA.92) – paragraph of Accounting Council’s Advice on the relevant standard
- FRS10x.GL – glossary of the relevant standard
- Chapter x (e.g. Chapter 3 Scope, concepts, principles and presentation) – chapter in this publication
- Section x (e.g. Section 3 Financial statement presentation) – section of the standard FRS 102

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Other ways KPMG professionals can help

This publication has been produced by UK DPP. There is a range of publications and guidance published by UK DPP and the KPMG International Standards Group that is available now (or in due course) to assist you further, including:

- **Illustrative financial statements** prepared under FRS 102;
- **Insights into IFRS**, that provides practical guidance on the application of IFRS;
- **IFRS Handbooks**, that include extensive interpretative guidance and illustrative examples to elaborate on or clarify the practical application of IFRS;
- disclosure checklists;
- e-learning modules on FRSs 100-102 from the KPMG Learning Academy.

For access to an extensive range of accounting, auditing and financial reporting guidance and literature, visit KPMG’s Accounting Research Online. This web-based subscription service can be a valuable tool for anyone who wants to stay informed in today’s dynamic environment. For a free 15-day trial, go to www.aro.kpmg.com and register today.

For further information see www.kpmg.co.uk or www.kpmg.com/ifrs
Abbreviations

• ‘Companies Act’ – Companies Act 2006
• ‘EU-IFRS’ – International Financial Reporting Standards as adopted by the European Union
• ‘FRC’ – Financial Reporting Council, the UK regulator that issues UK accounting standards
• ‘FRS’ – Financial Reporting Standard
• ‘FRSSE’ – Financial Reporting Standard for Smaller Entities
• ‘GAAP’ – Generally Accepted Accounting Practice/Principles
• ‘IAS’ – International Accounting Standard
• ‘IFRIC’ – IFRS Interpretations Committee (previously the International Financial Reporting Interpretations Committee)
• ‘IFRS’ – International Financial Reporting Standard
• ‘Insights into IFRS’ – KPMG’s Insights into IFRS publication
• ‘LLP’ – Limited Liability Partnership
• ‘Regulations’ – The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations, Statutory Instrument 2008/410
• ‘SIC’ – Standing Interpretations Committee
• ‘SORP’ – Statement of Recommended Practice
• ‘SSAP’ – Statement of Standard Accounting Practice
• ‘UITF’ – Urgent Issues Task Force
• ‘UK GAAP’ – United Kingdom Generally Accepted Accounting Practice/Principles
Introduction
INT.1 The financial reporting standards for the UK and Republic of Ireland have been revised for periods beginning on or after 1 January 2015. All of the standards in existing UK GAAP have been replaced by three standards:

FRS 100 Application of Financial Reporting Requirements
FRS 101 Reduced Disclosure Framework
FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland

INT.2 These FRSs bring UK GAAP up to date and increase consistency with International Financial Reporting Standards.

INT.3 The FRC will be issuing proposals for a further standard, FRS 103 Insurance contracts. FRS 103 will replace FRS 27 Life assurance and the SORP Accounting for Insurance Business for applicable entities, which will not be able to early-adopt FRS 102 until FRS 103 has been issued. This standard will apply to:

(a) insurance contracts (including reinsurance contracts) issued and reinsurance contracts held by the entity; and
(b) financial instruments with a discretionary participation feature issued by the entity. [FRS102.1.6]

INT.4 FRS 100 sets out the financial reporting requirements for UK and Ireland entities preparing financial statements that are intended to give a true and fair view. See Chapter 1 of this publication.

INT.5 FRS 101 sets out a reduced disclosure framework that may be applied in the individual financial statements of qualifying group entities that otherwise apply the requirements of EU-IFRS. See Chapter 2 of this publication.

INT.6 FRS 102 is a single standard providing concise financial reporting requirements, based on the International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs) as amended for use in the UK and Ireland. It replaces the previous body of UK GAAP accounting standards. See Chapters 3 to 35 of this publication.

INT.7 The FRSSE may be applied by entities meeting the small companies exemptions of the Companies Act, or entities that are not companies but would otherwise be entitled to those exemptions if they had been incorporated under the Companies Act.

1 With the exception of FRS 27, which will be replaced by FRS 103 in due course; see paragraph INT.3 of this publication.
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Application of financial reporting requirements
Overview of requirements

- Depending on eligibility and legal and regulatory requirements, UK and Ireland private sector entities apply EU-IFRS, FRS 101 or FRS 102 (with or without reduced disclosures), or the FRSSE in preparing their group and individual financial statements.
- An entity applying FRS 102 or the FRSSE also applies a SORP if required or relevant.
- An entity states the framework it is applying in the notes to its financial statements.
- FRSs 100, 101 and 102 are applicable for periods beginning on or after 1 January 2015. Early adoption is permitted subject to certain conditions.
- Transitional requirements are as specified in FRS 100, FRS 101 and FRS 102.
- Qualifying entities within a group may apply a reduced disclosure framework in their individual financial statements under FRS 101 or FRS 102.
- Guidance on 'equivalence' is given in the Application Guidance to FRS 100.
1.1 FRS 100 sets out the financial reporting requirements for UK and Ireland entities preparing financial statements that are intended to give a true and fair view. [FRS100.2] It does not, however, apply to the financial statements of entities within the public sector1, whose financial reporting framework is determined by the Relevant Authorities2 and is generally based on EU-IFRS as adapted for use in the public sector (see the Foreword to Accounting Standards paragraph 21).

1.2 Financial statements within the scope of FRS 100 are prepared, depending on eligibility, in accordance with either EU-IFRS, FRS 101 Reduced disclosure framework, FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland, or the FRSSE. [FRS100.4]

1.3 EU-IFRS is applied when required by law or regulation (for example, in the consolidated financial statements of fully listed or AIM companies).

1.4 FRS 101 sets out a reduced disclosure framework that may be applied in the individual financial statements of qualifying group entities (see paragraph 1.22 of this publication) that otherwise apply the requirements of EU-IFRS. This framework is discussed further in Chapter 2 of this publication.

1.5 FRS 102 replaces the previous body of UK GAAP standards and is discussed in Chapters 3 to 35 of this publication. It also includes reduced disclosure exemptions for qualifying group entities.

**Basis of preparation of financial statements**

1.6 The applicable standards are summarised in the following table. Any entity can ‘trade up’ and apply a ‘higher’ standard (for example, an entity eligible to apply the FRSSE may choose instead to apply FRS 102).

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1 The public sector includes those entities classified as such by the Office for National Statistics.

2 The Relevant Authorities in the UK are: HM Treasury, the Welsh Assembly Government, the Scottish Government, the Northern Ireland Assembly, CIPFA/LASAAC, the Department of Health and Monitor (Independent Regulator for NHS Foundation Trusts).
Interaction with Companies Act requirements

1.7 Financial statements of a company prepared in accordance with FRS 101, FRS 102 (with or without reduced disclosures) or the FRSSE are ‘Companies Act accounts’ as defined by section 395 of the Companies Act. Only those prepared under EU-IFRS are ‘IAS accounts’.

1.8 The Companies Act specifies that charitable companies prepare Companies Act accounts so they are not eligible to apply EU-IFRS in their individual or group accounts.

1.9 Section 407 of the Companies Act requires the individual financial statements of UK subsidiary companies within a group, where the parent prepares consolidated financial statements, to be prepared on a consistent basis (i.e. all Companies Act accounts or IAS accounts) unless there are good reasons not to. The individual financial statements of the parent company are prepared on the same basis as those of the subsidiaries except when the parent company prepares IAS group accounts and IAS individual accounts. As only individual financial statements prepared under EU-IFRS are considered to be IAS accounts, it is possible for different subsidiaries within a group to apply FRS 101 and FRS 102 (and, if eligible, the FRSSE) in their individual financial statements without breaching the Companies Act consistency requirement.

1.10 Previously, once a company had prepared its consolidated or individual accounts under EU-IFRS, it could not revert to UK GAAP in a later financial year unless there was a specified ‘relevant change in circumstances’ (e.g. if the company (or its parent) ceased to have its securities admitted to trading on a regulated market in an EEA state (Companies Act sections 395 and 403)). Recent changes to the Companies Act that apply for periods ending on or after 1 October 2012 have now also introduced a free choice for a company to revert to UK GAAP (which will include FRS 101 and FRS 102) from EU-IFRS as long as it has not in the last five years previously reverted to UK GAAP (other than as a result of a relevant change in circumstances).

1.11 Certain requirements of the Companies Act apply even when the financial statements are prepared in accordance with EU-IFRS. This includes disclosures in relation to related undertakings and directors’ benefits, and the requirement to prepare a directors’ report and (if applicable) a directors’ remuneration report. [FRS100.A2.18-19]

Non-companies

1.12 Many entities applying FRS 100 are not companies and will need to consider whether there are any conflicts with the legislation or regulation applicable to them. [FRS100.A2.20] The FRC has considered the legislation for the form and content of accounts for the following and has concluded that there are no significant areas of conflict with FRS 102:

- Building Societies Act 1986;
- Charities Act 2011;
- Charities and Trustee Investments Act (Scotland) 2005;
- Charities Act (Northern Ireland) 2008;
- Friendly and Industrial and Provident Societies Act 1968;
- Friendly Societies Act 1992; and
- The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996.

1.13 Certain entities may be required to comply with additional regulations on top of the legal requirements and accounting standards, and some fall within the scope of SORPs, which will be updated to reflect the requirements of FRS 102. [FRS100.A2.21]

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3 Charitable companies are not permitted to prepare IAS accounts and are not required to apply the same financial reporting framework as non-charity subsidiaries.

4 The European Economic Area (EEA) comprises the countries of the European Union (EU), plus Iceland, Liechtenstein and Norway. It does not include the Channel Islands, the Isle of Man, or Gibraltar.
Statements of recommended practice (SORPs)

1.14 SORPs are intended to improve comparability between entities within a sector. In developing its accounting policies, an entity applying FRS 102 or the FRSSE may apply a SORP if it is in scope of that SORP (or may be required to do so by applicable law or regulation) or may choose to apply a SORP that is relevant to it provided the SORP does not conflict with the requirements of the accounting standard applied. If an entity applies a SORP it states this in its financial statements. Any departures from the accounting or disclosures of the SORP are disclosed. [FRS100.5-8, FRS102.10.5]

Statement of compliance

1.15 An entity includes a statement of compliance in the notes to its financial statements specifying whether it is applying FRS 102, the reduced disclosure framework of FRS 102, FRS 101 or the FRSSE. Entities applying full EU-IFRS are required by IAS 1.16 to give an equivalent statement of compliance. [FRS100.9]

Effective date and transition

1.16 FRSs 100, 101 and 102 are applicable for periods beginning on or after 1 January 2015. Early adoption is permitted. [FRS100.10] However, early adoption of FRS 101 may be restricted for companies that previously applied EU-IFRS in their individual financial statements to periods ending on or after 1 October 2012 (see paragraph 1.10 of this publication). In addition, early adoption of FRS 102 is restricted to periods ending on or after 31 December 2012 and, for entities within the scope of a SORP, early adoption of FRS 102 is permitted only if the standard does not conflict with the requirements of a current SORP or legal requirements for the preparation of financial statements.

1.17 On transition an entity applies the following: [FRS100.11]
(a) for transition to EU-IFRS – IFRS 1 – see Insights into IFRS Chapter 6;
(b) for transition to FRS 101 unless the entity previously applied EU-IFRS – IFRS 1 paragraphs 6-33 as amended by FRS 101.5(b) – see paragraph 2.11 of this publication;
(c) for transition to FRS 101 when the entity previously applied EU-IFRS – the entity does not reapply IFRS 1 but considers whether adjustments are necessary to comply with FRS 101.5(b) [FRS100.12] – see paragraph 2.12 of this publication;
(d) for transition to FRS 102 – the requirements in Section 35 Transition to FRS 102 – see Chapter 35 of this publication;
(e) for transition to the FRSSE – there are no specific transition requirements in the FRSSE. An entity applying the FRSSE for the first time would therefore need to apply all FRSSE requirements retrospectively for any transactions or balances in the financial statements at the date of transition, except to the extent that any parts of the standard applied prospectively from a specific date. Note that FRS 100 introduced changes to the FRSSE, resulting in a new version of the FRSSE (effective January 2015) that is outside the scope of this publication.

Equivalence

1.18 FRS 100 includes application guidance on equivalence both for the purpose of considering exemption from consolidation under section 401 of the Companies Act and for the purpose of the disclosure exemptions potentially available under FRS 101 and FRS 102 (see paragraphs 1.28 to 1.30 of this publication).

1.19 Under section 401 of the Companies Act, a parent company that is the subsidiary of a non-EEA parent may be exempt from preparing consolidated financial statements if (among other conditions) it is included in a higher consolidation that is prepared in a manner ‘equivalent’ to financial statements prepared in accordance with the EU Fourth and Seventh Directives. UITF 43 previously provided guidance on the meaning of equivalence for this purpose, which has now been included in the Application Guidance to FRS 100.
1.20 The Application Guidance indicates that only FRS 102 and EU-IFRS will automatically be equivalent for this purpose. Full IFRS may be equivalent subject to consideration of the reason for the difference from EU-IFRS. Higher consolidated financial statements prepared under other GAAPs require specific consideration. Some such GAAPs are closely related to full IFRS, for these FRS 100 requires consideration to be given to differences from EU-IFRS. For others it requires comparison, based on the particular facts, with the Seventh Directive. In this respect, only the basic requirements of the Fourth and Seventh Directives are required to be met, in particular the requirement to give a true and fair view; strict conformity with every provision of the Directives is not necessary. FRS 100 does, however, make specific reference to US, Canadian, Japanese, Chinese, and South Korean GAAPs. It observes that these are considered by the European Commission to be equivalent to EU-IFRS. Although FRS 100 makes this observation, it does not give any definitive position on those GAAPs’ equivalence to the Seventh Directive, but requires assessment of the particular facts and advises against being overly cautious. [FRS100.AG4-AG7]

Reduced disclosure frameworks

1.21 FRS 101 and FRS 102 offer reduced disclosure frameworks that may be applied in the individual financial statements of qualifying entities provided certain criteria are met (see paragraphs 1.22 to 1.34 of this publication). The available disclosure exemptions are discussed in Chapters 2 and 3 of this publication. The reduced disclosure frameworks may not be applied in any consolidated financial statements. [FRS101.3, FRS102.1.10]

Definition of qualifying entity

1.22 A qualifying entity is a member of a group where the parent of that group prepares publicly available consolidated financial statements that are intended to give a true and fair view and that member is included in the consolidation. [FRS101.GL, FRS102.GL]

1.23 The definition of a qualifying entity for FRS 101 (but not for FRS 102) purposes has additional wording that excludes charities from being qualifying entities. Charitable companies within a group may not apply FRS 101 in their individual financial statements but may (subject to meeting the necessary conditions) apply the reduced disclosures offered for qualifying entities under FRS 102. [FRS101.GL]

1.24 Part of the definition of a qualifying entity under FRS 101 and FRS 102 is that the consolidated financial statements in which the group entity is included are ‘intended to give a true and fair view’. This is not a question of whether they do in fact give a true and fair view but whether they are intended to do so, presumably under legal or regulatory requirements. When the GAAP applied in the consolidated financial statements is EU-IFRS, full IFRS or FRS 102, or is considered to be equivalent for the purpose of section 401 of the Companies Act (see paragraph 1.20 of this publication), we consider that this condition will be met. For other GAAPs it will be necessary to consult the wording of the applicable legal and regulatory requirements in order to determine whether the consolidated financial statements are intended to give a true and fair view.

1.25 ‘Included in the consolidation’ means that the entity is included in the consolidated financial statements on a full (not proportional) consolidation basis. [FRS101.GL, FRS102.GL] The definition of a qualifying entity includes both subsidiaries and the parent of a group (assuming that the necessary criteria are met).

Criteria for applying a reduced disclosure framework

1.26 A qualifying entity may apply the reduced disclosure framework of FRS 101 or FRS 102 only if both of the following conditions are met:

(a) Its shareholder(s) have been notified in writing about, and do not object to, the application of the disclosure exemptions. Only shareholder(s) holding five percent or more of the total allotted shares of the entity, or more than half of the allotted shares not held by the immediate parent, are entitled to serve an objection. The entity specifies a reasonable time frame and format for objections. [FRS101.5(a), FRS102.1.11(a)] Whilst this condition may be relatively straightforward to meet in the case of a wholly-owned subsidiary within a group, listed ultimate parent companies may find this condition more challenging logistically. Such companies will need to plan carefully the method by which they will obtain this permission, for example as part of the Annual General Meeting process or via a separate communication with shareholders.

(b) The financial statements summarise (in narrative form) the exemptions applied and identify the consolidated financial statements in which the entity is consolidated. [FRS101.5(c), FRS102.1.11(c)]
FRS 101 – consequential amendments to EU-IFRS

1.27 Since financial statements prepared in accordance with FRS 101 are Companies Act accounts (see paragraph 1.7 of this publication), qualifying entities applying FRS 101 make certain amendments to the requirements of EU-IFRS in order to comply with the requirements of the Companies Act; these are discussed in Chapter 2 of this publication. [FRS101.5(b)]

Equivalent disclosures

1.28 Certain (but not all) of the disclosure exemptions available in FRS 101 and FRS 102 are conditional upon equivalent disclosures being included in the consolidated financial statements of the group in which the entity is consolidated. The Application Guidance to FRS 100 provides guidance on the meaning of equivalence for this purpose.

1.29 There is no requirement for the higher consolidated financial statements to be prepared under any specific GAAP (subject to the general requirement that they are intended to give a true and fair view – see paragraph 1.24 of this publication) and only the basic disclosure requirements of the relevant standard need to be met; compliance with every disclosure requirement of that standard is not required. Disclosure exemptions for qualifying entities are permitted even when the disclosures in the consolidated financial statements are made in aggregate or in an abbreviated form. However, no disclosure exemption is available in the individual financial statements of a qualifying entity (subject to materiality considerations at the entity level) if no disclosure is made in the higher consolidated financial statements on the grounds of materiality from that consolidated point of view. [FRS100.AG8-10]

1.30 The standard is silent as to whether disclosure is required in the individual financial statements of material items that are potentially within the scope of the disclosure exemptions but eliminate on consolidation (for example, intra-group derivatives) and hence are not themselves disclosed in the consolidated financial statements. However, the wording of the Application Guidance suggests that a disclosure exemption would be available for such items if disclosure is made in the consolidated financial statements in relation to external items of the same nature (in this example, external derivatives).
Financial institutions

1.31 A qualifying entity that is a financial institution is not exempt from disclosures in relation to financial instruments. [FRS101.7, FRS102.1.9]

1.32 A financial institution includes any of the following: [FRS101.GL, FRS102.GL]
   
   (a) a bank that is:
      
      (i) a firm with a Part IV permission\(^6\) that includes accepting deposits and:
         - that is a credit institution; or
         - whose Part IV permission includes a requirement that it complies with the rules in the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment Firms relating to banks, but which is not a building society, a friendly society or a credit union;
      
      (ii) an EEA bank that is a full credit institution;
   
   (b) a building society that is defined in section 119(1) of the Building Societies Act 1986 as a building society incorporated (or deemed to be incorporated) under that act;
   
   (c) a credit union, being a body corporate registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act 1979, that is an authorised person;
   
   (d) a custodian bank, broker-dealer or stockbroker;
   
   (e) an entity that undertakes the business of effecting or carrying out insurance contracts, including general and life assurance entities;
   
   (f) an incorporated friendly society incorporated under the Friendly Societies Act 1992 or a registered friendly society registered under section 7(1)(a) of the Friendly Societies Act 1974 or any enactment that it replaced, including any registered branches;
   
   (g) an investment trust, Irish Investment Company, venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC);
   
   (h) a retirement benefit plan; or
   
   (i) any other entity whose principal activity is to generate wealth or manage risk through financial instruments.

   This is intended to cover entities that have business activities similar to those listed above but are not specifically included in the list above.

1.33 A parent entity whose sole activity is to hold investments in other group entities is not a financial institution.

1.34 A subsidiary entity engaged solely in treasury activities for the group as a whole is likely to meet the definition of a financial institution. [FRS102.ACA.37]

\(^6\) As defined in section 40(4) of the Financial Services and Markets Act 2000.
Reduced disclosure framework
Overview of requirements

- FRS 101 sets out the disclosure exemptions available in the individual financial statements of qualifying entities within a group that otherwise apply the requirements of EU-IFRS (as modified by FRS 101 in order to comply with the Companies Act).

- A qualifying entity is a member of a group where the parent of that group prepares publicly available consolidated financial statements that are intended to give a true and fair view and that member is included in the consolidation.

- FRS 101 cannot be applied in any consolidated financial statements.

- Financial statements prepared under FRS 101 are Companies Act accounts; certain amendments to the requirements of EU-IFRS (including the use of Companies Act formats) are therefore required to ensure compliance with the Companies Act.

- Qualifying entities that are financial institutions are not exempt from the financial instrument disclosure requirements of IFRS 7 and IFRS 13.
FRS 101

2.1 FRS 101 sets out the disclosure exemptions available in the individual financial statements of qualifying entities within a group that otherwise apply the requirements of EU-IFRS (as modified by FRS 101). A qualifying entity is a member of a group where the parent of that group prepares publicly available consolidated financial statements that are intended to give a true and fair view and that member is included in the consolidation. The definition of a qualifying entity, and the general criteria for applying a reduced disclosure framework as set out in FRS 101, is discussed in paragraphs 1.21 to 1.30 of this publication.

2.2 Qualifying entities that are required or choose to prepare consolidated financial statements may not apply FRS 101 in those financial statements. [FRS101.3]

2.3 Entities applying FRS 101 make a statement of compliance with that standard in the notes to the financial statements. It is not appropriate to include a statement of compliance as set out in IAS 1.16 since the financial statements will not comply with all of the requirements of EU-IFRS.

Amendments to EU-IFRS requirements

2.4 As financial statements prepared under FRS 101 are Companies Act accounts (see paragraph 1.7 of this publication), certain amendments to the requirements of EU-IFRS are required in order to comply with the Act. [FRS101.5(b)] These are discussed in the Application Guidance to the standard and include:

- The presentation formats of the Companies Act apply rather than those of IAS 1. The requirements of IAS 1 may be applied to the extent that they do not conflict with the Companies Act requirements.
- The true and fair override is applied in relation to the non-amortisation of goodwill.
- Negative goodwill is not recognised immediately in profit or loss. It is instead carried on the balance sheet and recognised in profit or loss generally in the same period(s) as the non-monetary assets acquired are recovered.
- Contingent consideration in a business combination is accounted for at its estimated amount when payment is considered probable and the amount can be measured reliably, rather than being included at its fair value at the acquisition date. Changes in contingent consideration are recognised as an adjustment to the acquisition cost rather than being recognised in profit or loss.
- The analysis of the results of discontinued operations is presented in a columnar format on the face of the statement of comprehensive income, together with a total column.
- Only realised profits may be recognised in profit or loss. However, movements in the value of financial instruments, investment properties and living animals or plants may nevertheless be recognised in profit or loss.
- Government grants related to assets are presented as deferred income and may not be credited to the cost of the related asset. Income from government grants is presented as income in profit or loss and may not be netted against the related expense.
- An impairment of goodwill is reversed if (and only if) the reasons for the impairment have ceased to apply.

2.5 Entities that are not companies make the same amendments to the requirements of EU-IFRS if applying FRS 101.

Disclosure exemptions

2.6 Under FRS 101 there is no requirement to: [FRS101.8]

- Present comparative movement tables in relation to share numbers, property, plant and equipment, intangible assets, investment properties and biological assets (IASs 1, 16, 38, 40, 41).
- Present a statement of cash flows (IAS 7).
- Disclose key management personnel compensation (IAS 24). However, for companies, disclosure of directors’ remuneration is required under the Companies Act (see paragraph 1.11 of this publication).
- Disclose related party transactions between wholly-owned subsidiaries and parents within a group (the same exemption applies under FRS 102 – see paragraph 33.7 of this publication) (IAS 24). This exemption does not extend to balances with group related parties that are required to be disclosed under the Companies Act.
Reduced disclosure framework

- Present a third balance sheet when restating comparative information (IAS 1).
- Disclose information in relation to new standards not yet applied (IAS 8).
- Give capital management disclosures (IAS 1) (although see paragraph 2.8(b) of this publication).

In addition, exemption from the following disclosure requirements is available, provided that equivalent disclosures are included in the consolidated financial statements. (FRS101.8) Equivalence for this purpose is discussed in the Application Guidance to FRS 100 (see paragraphs 1.28 to 1.30 of this publication).

- Detailed disclosures in relation to certain group share-based payment arrangements (IFRS 2). This exemption does not include: for a subsidiary, arrangements over its own equity instruments; or for an ultimate parent, arrangements that are not over its own equity instruments.
- Detailed disclosures in relation to business combinations, including current and comparative period movement tables in relation to goodwill (IFRS 3). However, movements in goodwill balances are nevertheless required to be disclosed under the Companies Act.
- Cash flow disclosures in relation to discontinued operations (IFRS 5).
- Disclosures in relation to the key assumptions used in the determination of recoverable amount for impairment purposes (IAS 36).
- Financial instrument disclosures (IFRS 7) (although see paragraph 2.8 of this publication).
- Disclosures in relation to fair value measurement (IFRS 13) (although see paragraph 2.8 of this publication).

However, an exemption from financial instrument disclosures is not available in the following cases:

(a) If the qualifying entity is not a financial institution but has financial instruments held at fair value (other than financial liabilities that are held at fair value as part of a trading portfolio or are derivatives), certain disclosure requirements of IFRS 7 and IFRS 13 are given in relation to those instruments in order to comply with the requirements of the Companies Act (this applies even if the entity is not a company). (FRS101.6)
(b) Qualifying entities that are financial institutions (see paragraph 1.31 of this publication) cannot apply the disclosure exemptions from either IFRS 7, IFRS 13 (to the extent that they apply to financial instruments), or the capital management disclosures of IAS 1. (FRS101.7)

Effective date and transitional arrangements

2.9 FRS 101 is applicable for periods beginning on or after 1 January 2015. Early adoption is permitted. However, early adoption may be restricted to periods ending or after 1 October 2012 for companies that previously applied EU-IFRS in their individual financial statements (see paragraph 1.10 of this publication).

2.10 The transitional requirements on adoption of FRS 101 are set out in FRS 100. The date of transition is the start of the earliest comparative period presented in the first financial statements prepared under FRS 101. (FRS101.GL)

2.11 A qualifying entity that did not previously apply EU-IFRS prior to the date of transition applies the requirements of IFRS 1.6-33 as adopted by the EU, including the relevant appendices (as amended by FRS 101.AG1, that requires a qualifying entity to measure its assets and liabilities in accordance with FRS 101). (FRS100.11(b))

2.12 A qualifying entity transitioning to FRS 101 that applied EU-IFRS prior to the date of transition considers whether amendments are required to comply with the amendments to EU-IFRS set out in FRS 101.AG1, but does not reapply the provisions of IFRS 1. When amendments to the recognition, measurement or disclosure requirements of EU-IFRS in accordance with paragraph 5(b) of FRS 101 are required, the entity considers whether the amendments have a material effect on the first financial statements prepared under FRS 101. If there is no material effect, the entity discloses that FRS 101 has been adopted and provides a narrative summary of the disclosure exemptions applied. If there is a material effect, the entity’s first financial statements prepared under FRS 101 include (for each period practicable):

(a) a description of the nature of each material change in accounting policy;
(b) reconciliations of equity under EU-IFRS to that under FRS 101 as at the date of transition to FRS 101 and as at the end of the latest period presented in the entity’s most recent annual financial statements prepared under EU-IFRS; and
(c) a reconciliation of profit or loss under EU-IFRS to that under FRS 101 for the latest period presented in the entity’s most recent annual financial statements prepared under EU-IFRS. (FRS100.12)
Scope, concepts, principles and presentation
Overview of requirements

- Entities, including public benefit entities, preparing financial statements intended to give a true and fair view apply FRS 102 when they are not eligible or required to apply another reporting framework (e.g. EU-IFRS, FRS 101 or FRSSE) or are eligible but choose not to do so.
- A statement of compliance with FRS 102 and, if applicable, that the entity is a public benefit entity, is given in the notes.
- Departures from FRS 102 or applicable legislation, and the reasons for it, are disclosed.
- If relevant an entity applies IAS 33, IFRS 8 and FRS 103 (once issued) in addition to FRS 102.
- Certain disclosure exemptions are available for qualifying entities.
- The objective of financial statements is to provide relevant financial information to users to inform their economic decisions.
- Financial statements comprise statements (and related notes) showing the financial position, financial performance and cash flows of an entity.
- Financial statements are understandable, relevant, reliable, prudent, complete, comparable and timely. They reflect substance not merely legal form and are free from bias.
- Items are recognised in an entity’s financial statements when they meet the definition of an asset, liability, income or expense, can be measured reliably and have a probable future economic benefit inflow or outflow.
- Performance is presented in a single statement of comprehensive income or a separate income statement and statement of comprehensive income.
- Income and expenses are recognised as a result of changes in recognised assets and liabilities.
- FRS 102 specifies the bases of measurement for assets, liabilities, income and expenses e.g. historical cost or fair value.
- Financial statements, except cash flow information, are prepared on an accruals basis.
- Offsetting of assets and liabilities or of income and expenses is not allowed unless required or permitted by FRS 102.
- Going concern is assessed by management for at least 12 months. In practice this look-forward period will be 12 months from the date of approval of the financial statements due to auditing standard requirements.
- Any material uncertainties or a non-going concern basis of preparation are disclosed.
- Financial statements are usually prepared annually and on a consistent basis. Comparatives are disclosed except when FRS 102 permits or requires otherwise.
- Material items are disclosed separately and materiality is considered in the financial statements aggregation process.
- Financial statements state the entity’s name, period end date, presentational currency, rounding level and whether they are group or company financial statements. They also disclose the registered office, country of incorporation and principal activities and operations.
pUK3.1 The concepts and principles of the ASB’s *Statement of Principles* are in line with those stated in FRS 102.

pUK3.2 FRS 5 and the *Statement of Principles* contain specific guidance on how to apply the principle that transactions are accounted for in accordance with their commercial substance. Application Notes to FRS 5 apply that principle to a variety of complex transaction types.

pUK3.3 The following are generally presented as primary statements: profit and loss account; statement of total recognised gains and losses; balance sheet; and (for certain entities) a cash flow statement. See Chapters 4 to 7 of this publication for further guidance.

pUK3.4 More entities are required to provide segmental reporting disclosures under SSAP 25 than under FRS 102, including certain large private entities and unlisted public limited companies. The detailed requirements of SSAP 25 also differ from those of IFRS 8 (which are applied by those required to provide segment information under FRS 102). This includes the possibility of a ‘seriously prejudicial’ exemption from disclosure that is not available under IFRS 8.
Scope

3.1 FRS 102 applies to financial statements intended to give a true and fair view of a reporting entity’s financial position and profit or loss. See Chapters INT, 1 and 2 of this publication for the scope and background to FRSs 100-102. This applies to both companies and public benefit and other entities. Certain paragraphs within FRS 102 are prefixed with ‘PBE’ and those apply only to public benefit entities and are not applied to other types of entity.

3.2 FRS 102 applies for accounting periods beginning on or after 1 January 2015. Early adoption is permitted for accounting periods ending on or after 31 December 2012, except for public benefit entities, for which early adoption is permitted only if it does not conflict with either the legal requirements for the preparation of the financial statements or the requirements of a current SORP. [FRS102.1.14] Disclosure is required when FRS 102 is early-adopted.

3.3 When an entity that applies FRS 102 is required, or chooses, to prepare the following it applies the following EU-IFRSs:

- earnings per share: IAS 33 [FRS102.1.4]
- segmental information: IFRS 8 [FRS102.1.5]

3.4 An entity is required to apply IAS 33 and IFRS 8 if its shares are publicly traded or if it files, or is in the process of filing, financial statements with a regulatory body for a public share issue. An entity applies FRS 103 Insurance contracts (once issued) if it issues insurance contracts or financial instruments with a discretionary participation feature; see the Introduction to this publication. [FRS102.1.6] There is no requirement to apply IFRS 4.

3.5 FRS 102 does not cover the presentation of interim financial reports and if such information is presented, then disclosure is made of the basis for preparing and presenting the information. [FRS102.3.25] The Accounting Standards Board’s Statement Half-yearly financial reports has been withdrawn and there is no requirement for those reporting under FRS 102 to apply IAS 34 (and IFRIC 10), although entities may choose to do so.

Reduced disclosures for qualifying group entities

3.6 The definition of a qualifying entity is discussed in paragraphs 1.22 to 1.25 of this publication.

3.7 Qualifying entities applying FRS 102 may apply the following disclosure exemptions in their individual accounts, provided they meet the criteria discussed in paragraph 1.26 of this publication. The exemptions may not be applied in any consolidated accounts. [FRS102.1.12]

- Statement of financial position – reconciliation of number of shares outstanding – FRS 102.4.12(a)(iv).
- Presentation of a cash flow statement – Section 7 Statement of cash flows and FRS 102.3.17(d).
- Disclosure of key management personnel compensation – FRS 102.33.7.
- Financial instruments – FRS 102.11.39-48A and FRS 102.12.26-29 except that:
  - qualifying entities that are financial institutions (see paragraph 1.32 of this publication) may not apply this exemption. Note that, in addition to the disclosure requirements of Section 11 Basic financial instruments and Section 12 Other financial instruments issues, such entities give further financial instrument disclosures as set out in Section 34 Specialised activities and Chapter 34D of this publication;
  - qualifying entities with financial liabilities held at fair value apply the disclosure requirements of paragraph FRS 102.11.48A. However, financial liabilities held at fair value that are part of a trading portfolio or are derivatives can take advantage of the exemption in FRS 102.1.12(c).

3.8 The exemptions listed in paragraphs 3.7(c) and (e) of this publication are dependent on the inclusion of equivalent disclosures in the consolidated financial statements of the group in which the entity is consolidated. The application guidance to FRS 100 includes further detail on equivalence. See paragraphs 1.28 to 1.30 of this publication.
**vs EU-IFRS**

Applicable standards: IASB Framework, IAS 1, IAS 34, IFRS 8, IFRS 13

IFRS3.1 FRS 102 and EU-IFRS are both based on the IASB Framework. However, the Framework contains concepts of capital and capital maintenance that are not defined in FRS 102.

IFRS3.2 Under EU-IFRS, there are fewer exceptions from the presentation of comparative information. For example, movements in property, plant and equipment are also presented for the comparative period.

IFRS3.3 IAS 1 requires an entity to present a statement of financial position (balance sheet) as at the beginning of the earliest comparative period when the entity applies an accounting policy retrospectively or corrects a prior period error, or when it reclassifies items in its financial statements.
Concepts and pervasive principles

3.9 FRS 102 sets out the concepts and pervasive principles that entities consider when preparing their financial statements, although it goes on to note that when there are specific requirements within FRS 102 that conflict with these principles, then the specific requirements apply.

3.10 The objective of financial statements is to provide information on the financial position, performance and cash flows of the entity that is useful to a broad range of users in making economic decisions. [FRS102.2.2] They also enable management’s stewardship of the company to be assessed. [FRS102.2.3]

3.11 Financial statements need to be understandable to users with a reasonable knowledge of business, economic activities and accounting and a willingness to study the information. However, relevant information may not be omitted on the grounds that it may not be understood by some users. [FRS102.2.4]

3.12 The information included in the financial statements needs to be relevant to users’ needs. Information is relevant when it might influence the economic decisions of users by helping them to evaluate past, present or future events. [FRS102.2.5]

3.13 If the omission or misstatement of a piece of information, either on its own or with others, could influence the economic decisions of the users, that information is material, and therefore relevant. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. However, it is inappropriate to make, or leave uncorrected, immaterial departures from FRS 102 in order to achieve a certain presentation in the financial statements. [FRS102.2.6]

3.14 Financial statements provide reliable information that is free from material error or bias and faithfully represents all information that users could reasonably expect or which the financial statements claim to include. If, in the selection and presentation of information, there is an intention to influence users’ judgement or decision-making in a particular way, the financial statements are not free from bias. [FRS102.2.7]

3.15 To enhance the reliability of financial statements, transactions are presented according to their substance and not just their legal form. [FRS102.2.8]

3.16 When uncertainties exist around events and conditions, appropriate disclosure is made and prudence is exercised in relation to those uncertainties in preparing the financial statements. When exercising judgement around estimates resulting from conditions of uncertainty, prudence is the inclusion of a degree of caution such that expenses and liabilities are not understated and assets and income are not overstated. However, the deliberate overstatement of liabilities and expenses or understatement of assets and income is not permitted; prudence does not permit bias. [FRS102.2.9]

3.17 Financial statements must be complete, while considering materiality and cost. Information may become unreliable or no longer relevant if an omission causes that information to be false or misleading. [FRS102.2.10]

3.18 Users of the financial statements must be able to compare an entity’s financial information both over time and to that of other entities so that they are able to evaluate the entity’s relative financial performance and position. Therefore, measurement and presentation of financial information must be on a consistent basis both for the entity over time and compared to other entities. The accounting policies used in preparation of the financial statements and any changes therein are disclosed to allow users to understand and compare financial statements. [FRS102.2.11]

3.19 Undue delay in the reporting of financial information may mean it loses relevance to influence the economic decisions of users and such information is therefore provided to users with a degree of timeliness. There may be a need for management to balance the need for timeliness, relevance and reliability of financial information when considering how best to satisfy the needs of users. [FRS102.2.12]

3.20 The cost of providing information should not exceed the benefits of that information. Judgement is required in evaluating the benefits and costs involved: the benefits may accrue to a broad range of users, and the costs may not be borne by those same users. [FRS102.2.13] A lower cost of capital may be enjoyed by the economy as a whole if financial reporting information enables capital providers to make better decisions. Individual entities may also enjoy better access to capital markets, a lower cost of capital, improved public relations, or better management decisions as a result of financial reporting. [FRS102.2.14]
Financial position
3.21 The relationship on a specific date between an entity’s assets, liabilities and equity as presented in the statement of financial position (balance sheet) is its financial position. An asset is defined as a resource from which future economic benefits are expected to flow as a result of control obtained from a past event. A liability is a present obligation arising from past events that is expected to be settled via an outflow of economic benefits. The residual interest in the entity’s assets after deducting all liabilities is equity. [FRS102.2.15]
3.22 Some items may meet the definition of an asset or liability but are not recognised in the financial statements as they do not meet the recognition criteria discussed in paragraphs 3.30 to 3.32 of this publication. [FRS102.2.16]
3.23 An asset’s potential, directly or indirectly, to contribute to the flow of cash and cash equivalents to the entity is its future economic benefit. The cash flows may be through use or disposal. [FRS102.2.17] An asset may or may not have physical form; some assets are intangible. [FRS102.2.18] The existence of an asset does not rely on a right of ownership, but more on the ability to control the expected future economic benefits. [FRS102.2.19]
3.24 Liabilities oblige an entity to act or perform in a particular manner by way of a present obligation that may be either legal or constructive. A legal obligation is enforceable by law and results from contractual or statutory requirements. A constructive obligation arises from the entity’s actions, either from an established pattern of past practices, published policies or a current specific statement that indicates to others that the entity will accept certain responsibilities. [FRS102.2.20]
3.25 A present obligation is normally settled through payment of cash, transfer of other assets, provision of services, the replacement with another obligation or conversion to equity. It is also possible to extinguish an obligation through the counterparty waiving or forfeiting its rights. [FRS102.2.21]
3.26 The residual interest in the entity’s assets after deducting all its liabilities is equity. Within the balance sheet, equity may be sub-classified to include, for example, shareholder contributions and retained earnings. [FRS102.2.22]

Performance
3.27 The relationship between income and expense in a reporting period is an entity’s performance. It is presented either in a single statement of comprehensive income or in two statements: an income statement and a statement of comprehensive income. [FRS102.2.23]
3.28 Income is defined as increases in economic benefits in the reporting period as a result of inflows or enhancements of assets or decreases in liabilities that result in increases in equity. When the inflow relates to a contribution from equity investors this is not income. [FRS102.2.23(a)] Income includes both revenue, that arises as part of the ordinary activities of the entity (e.g. sales, fees, interest, royalties, dividends and rent), and gains, that are items other than revenue that meet the definition of income (e.g. the gain on sale of an item of property, plant and equipment (PP&E)). Gains are often presented separately in the statement of comprehensive income to aid users’ understanding. [FRS102.2.25]
3.29 Expenses are decreases in economic benefits in the reporting period as a result of asset outflows or additional liabilities incurred that decrease equity. Distributions to equity investors are not expenses. [FRS102.2.23(b)] Expenses include both amounts that arise in the course of the entity’s ordinary activities (e.g. cost of sales, wages and depreciation) that result in an outflow or depletion of assets, and losses, that are other items that meet the definition of expenses and that may arise in the ordinary course of business (e.g. the loss on sale of an item of PP&E). Losses are often presented separately in the statement of comprehensive income to aid users’ understanding. [FRS102.2.26]

Recognition of assets, liabilities, income and expenses
3.30 An asset is recognised in the balance sheet when it is controlled by the entity, the flow of future economic benefits is probable and its cost or value can be measured reliably. An asset is not recognised in respect of expenditure when the associated future economic benefits are all expected to be received in the current reporting period. In this case the amount is reported as an expense in the statement of comprehensive income or income statement. [FRS102.2.37]
3.31 A liability is recognised in the balance sheet when it is an obligation as a result of a past event, the settlement amount can be measured reliably and the transfer of economic benefits in settlement is probable. [FRS102.2.39]
To assess whether the flow of economic benefits is probable, the evidence available when the financial statements are prepared that relates to the conditions at the end of the reporting period is assessed. The assessment is either made individually or for a group of items, depending on their significance. [FRS102.2.29]

The cost or value of an item is often known or a reasonable estimate can be made. If a reasonable estimate cannot be made the item is not recognised in the financial statements. [FRS102.2.30] An unrecognised item may qualify for recognition at a later date if events and circumstances change. [FRS102.2.31] It may also warrant disclosure in the notes to the financial statements when it is relevant to the evaluation of performance or financial position by users of the financial statements. [FRS102.2.32]

The recognition of income and expenses results directly from the recognition and measurement of assets and liabilities. Income/expense is recognised in the statement of comprehensive income (or income statement) when an increase/decrease in future economic benefit has arisen as a result of an increase/decrease in an asset or decrease/increase in a liability that can be measured reliably. [FRS102.2.24, FRS102.2.41-42]

The arithmetic difference between income and expenses is total comprehensive income. [FRS102.2.43] Profit or loss is the arithmetic difference between income and expenses other than income or expenses classified under FRS 102 as other comprehensive income. [FRS102.2.44] See paragraph 5.3 of this publication.

Disclosure of the accounting policies used or additional explanatory material in the notes does not rectify failure to recognise an item that meets the criteria. [FRS102.2.28]

Assets and liabilities that do not meet the recognition criteria are not recognised in the balance sheet regardless of applying the so-called ‘matching concept’ to items in profit or loss. The ‘matching concept’ refers to the recognition in the same period of all gains and losses relating to the same overall transaction or event. [FRS102.2.45]

Contingent assets are not recognised in the financial statements. However, when the flow of economic benefits associated with a contingent asset becomes virtually certain the asset meets the asset recognition criteria and is recognised. [FRS102.2.38]

A contingent liability is either a present obligation that does not meet the recognition criteria of a liability or is a possible but uncertain obligation. Contingent liabilities are not recognised unless acquired as part of a business combination. [FRS102.2.40] See paragraph 19.10 of this publication.

Measurement of assets, liabilities, income and expenses

Assets, liabilities, income and expenses are measured to determine the amount at which they are recognised in the financial statements. FRS 102 specifies the measurement basis to be used for different types of assets, liabilities, income and expense, including historical cost or fair value. [FRS102.2.33]

Historical cost, for assets, is the fair value at the date of acquisition of the consideration given to acquire the asset. For liabilities the historical cost is the fair value of the proceeds or assets received in exchange for the obligation at the date of the transaction. However, in some cases the amount of cash or cash equivalents expected to be paid to settle the obligation may be a more appropriate measurement. [FRS102.2.34]

Amortised historical cost is the historical cost of the asset or liability less any portion of the historical cost already recognised as an expense or income. Fair value is the amount at which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged between knowledgeable, willing parties in an arm’s length transaction. [FRS102.2.34]

Assets and liabilities are recognised at historical cost on initial recognition unless required by another section of FRS 102 to be recognised on a different measurement basis (e.g. fair value). [FRS102.2.46]

Subsequent to initial recognition, basic financial assets and liabilities (as defined in Section 11) are recognised at amortised cost less impairment, except for:

- investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are publicly traded or whose fair value can otherwise be measured reliably; and
- any financial instrument that upon initial recognition was designated by the entity as at fair value through profit or loss.

These instruments are measured at fair value with changes in fair value recognised in profit or loss. [FRS102.2.47]

Other financial assets and liabilities are measured at fair value with changes in fair value recognised in profit or loss, unless FRS 102 requires or permits another measurement basis such as amortised cost. [FRS102.2.48]

Most non-financial assets are subsequently measured on a different basis from their initial measurement at historical...
cost, for example the cost model or revaluation model for property, plant and equipment; the lower of cost and selling price less costs to complete and sell for inventories; or the cost or fair value model for investments in associates and joint ventures and agricultural assets. [FRS102.2.49-50]

3.48 Investment property is required to be measured at fair value under FRS 102 when the fair value is readily determinable without undue cost or effort: see Chapter 16 of this publication. [FRS102.2.50]

3.49 Most liabilities other than financial liabilities are subsequently measured at the best estimate of the amount required to settle the obligation at the reporting date. [FRS102.2.51]

Pervasive recognition and measurement principles

3.50 The recognition and measurement criteria set out in FRS 102 are based on the pervasive principles that are derived from the IASB’s Framework for the Preparation and Presentation of Financial Statements (now called the Conceptual Framework for Financial Reporting) and from EU-IFRS. When specific guidance on a transaction or event is not given in FRS 102, the guidance on the judgement and selection of accounting policies in Section 10 Accounting policies, estimates and errors is followed (see paragraph 10.2 of this publication). After consideration of specific guidance within FRS 102, the concepts and principles of Section 2 Concepts and pervasive principles, discussed in this chapter, are followed. [FRS102.2.35]

Accruals basis

3.51 Except for cash flow information, financial statements are prepared on an accruals basis. As such, items are recognised when they meet the definitions and recognition criteria set out in FRS 102. [FRS102.2.36]

Offsetting

3.52 Assets and liabilities are not offset unless required or permitted by FRS 102. However, measuring assets net of a valuation allowance is not offsetting. Also, if buying and selling non-current assets is not part of the entity’s normal operating activities, then any gains and losses on disposal of these assets are reported by deducting the carrying amount and any selling expenses from the proceeds of sale. [FRS102.2.52]

Fair presentation

3.53 Financial statements present fairly an entity’s financial position, financial performance and cash flows. This requires faithful presentation of all transactions and other events and conditions in accordance with the recognition criteria of Section 2. Application of FRS 102 is assumed to result in a fair presentation of financial statements when coupled with any additional disclosures given when the requirements of FRS 102 are insufficient for users to understand fully the effect of certain transactions. [FRS102.3.2]

3.54 Fair presentation is the same as a ‘true and fair view’ as required for companies by section 393 of the Companies Act.

3.55 In the notes to the financial statements an explicit statement is made that the financial statements comply with FRS 102 when this is the case. [FRS102.3.3] In addition, a public benefit entity makes an explicit and unreserved statement that they are a public benefit entity when they have applied the ‘PBE’ prefixed paragraphs. In some extremely rare cases, compliance with FRS 102 or applicable legislation may be so misleading that management believes it conflicts with the objectives of the financial statements. [FRS102.3.4] In this case, management departs from the requirements of FRS 102 and makes certain disclosures, including the reasons why the application of the requirements of FRS 102 or applicable legislation would be misleading. This is known as a ‘true and fair override’. [FRS102.3.5]

Going concern

3.56 Management makes an assessment of the entity’s ability to continue as a going concern when preparing financial statements. Unless management intends or has no realistic alternative but to liquidate or cease operations of the entity, the entity is a going concern. In making this assessment all relevant information about the future is considered, that covers a period of at least 12 months from the date of approval of the financial statements. [FRS102.3.8]

3.57 If material uncertainties exist that cast significant doubt on the entity’s ability to continue as a going concern, then those uncertainties are disclosed. [FRS102.3.9]

3.58 If the financial statements are not prepared on a going concern basis, then the basis used to prepare the financial statements and the reasons why the entity is not considered to be a going concern are disclosed. [FRS102.3.9]
Frequency of reporting

3.59 At least annual presentation of a complete set of financial statements is generally required, although more or less frequent reporting may apply if the entity changes its reporting date. If the period is longer or shorter than one year due to a change in reporting date, that fact is disclosed along with the relevant rationale. The disclosure also states that comparative information may not be entirely comparable. [FRS102.3.10]

Consistency of presentation

3.60 The presentation and classification of financial statements is consistent year on year unless:

- FRS 102 or another applicable FRS or FRC Abstract requires a change in presentation; or
- a significant change in the nature of the entity’s operations or a review of the financial statements indicates that a different presentation would be more appropriate (see Chapter 10 of this publication). [FRS102.3.11]

3.61 Comparative amounts are reclassified when a change in presentation occurs, unless it is impracticable to do so. Disclosure is made of the nature, amount and reason for the reclassification. [FRS102.3.12]

Comparatives

3.62 Comparative information is always disclosed for the previous reporting period unless FRS 102 permits or requires otherwise. [FRS102.3.14] For example, Section 17 Property, plant and equipment does not require the reconciliation of the carrying amount at the beginning and end of the period to be presented for the prior period.

Materiality and aggregation

3.63 Each material (see paragraph 3.13 of this publication) class of similar items is presented separately. [FRS102.3.15] Transactions are aggregated depending on their nature or function and then classified as line items either in the financial statements or notes depending on materiality. [FRS102.3.16] Disclosures need not be given if the information is not material. [FRS102.3.16A]

Complete set of financial statements

3.64 A complete set of financial statements includes a statement of financial position (balance sheet) at the reporting date, either a single statement of comprehensive income for the reporting period or a separate income statement (profit and loss account) and statement of comprehensive income, a statement of changes in equity for the reporting period, a statement of cash flows for the reporting period (when applicable, see Chapter 7 of this publication) and related notes. [FRS102.3.17] On the basis that comparatives are required for the previous reporting period (see paragraph 3.62 of this publication), this effectively means that a complete set of financial statements includes two of each of the above statements and notes.

3.65 If there is no other comprehensive income in the current or comparative periods, the entity may present only an income statement rather than an income statement and a separate statement of comprehensive income. If the only changes to equity in the periods for which the financial statements are presented are from profit or loss, dividends, and correction of prior period errors or changes in accounting policy, a single statement of income and retained earnings may be presented in place of a statement of comprehensive income and statement of changes in equity. [FRS102.3.18]

3.66 Each financial statement (primary statement) is presented with equal prominence. [FRS102.3.21] A different title may be used to those outlined in FRS 102 as long as it is not misleading. [FRS102.3.22] Entities are required to comply with the financial statement formats of FRS 102 and with company (or LLP) law where referred to by FRS 102, except to the extent that these requirements are not permitted by any statutory framework under which such entities report. See Appendix II of this publication for common profit and loss account and balance sheet formats under the Act.

Identification

3.67 Each financial statement and its related notes are distinguished clearly from other information in the same document.

3.68 The reporting entity name and any changes in name in the period, the reporting date and period, the presentation currency, the level of rounding used and whether the financial statements are group or individual are displayed prominently in the financial statements and repeated as necessary to aid understanding. The domicile and legal form of the entity, country of incorporation and registered address are disclosed in the financial statements alongside a description of the nature of the entity’s operations and principal activities. [FRS102.3.23-24]
Statement of financial position (Balance sheet)
Overview of requirements

• The statement of financial position (which may also be called the balance sheet) is presented in accordance with the Companies Act formats. This applies even if the entity is not required to prepare accounts in accordance with the Companies Act (for example an entity that is not a company), unless the applicable legislation does not permit this.
**vs previous UK GAAP**

Applicable standards: FRS 2, FRS 25, FRS 28, UITF 4

pUK4.1 Previous UK GAAP also requires the balance sheet to be presented in accordance with the Companies Act schedules so this is not a GAAP difference for companies. For other entities, the Companies Act formats will apply under FRS 102 whereas they were not mandated under previous UK GAAP. Appendix IV to FRS 102 details other legal frameworks and the Accounting Council does not believe the formats required by these frameworks are inconsistent with FRS 102.

**vs EU-IFRS**

Applicable standards: IAS 1, IAS 8, IFRS 5

IFRS4.1 IFRS 5 requires the separate presentation of assets classified as held for sale or assets and liabilities included in a disposal group held for sale either in the statement of financial position or in the notes. FRS 102 contains no definition of held for sale and it is not included in the definition of discontinued operations. FRS 102 requires separate disclosure of the disposal group in the notes only when there is a binding sale agreement, whereas IFRS 5 disclosure and remeasurement is required also when the sale is highly probable.
4.1 The balance sheet is prepared as at an entity’s reporting date. [FRS102.4.1]

4.2 An entity presents its balance sheet in line with Part 1 General Rules and Formats of either:
   (a) Schedule 1 to the Regulations (applies to all entities other than those applying (b), (c), or (d), unless legislation specific to the entity requires a different format, see paragraph 1.12 of this publication);
   (b) Schedule 2 to the Regulations (applies to banking entities);
   (c) Schedule 3 to the Regulations (applies to insurance entities); or
   (d) Schedule 1 to the LLP Regulations (applies to LLPs).

4.3 A group balance sheet is presented in line with Schedule 6 to the Regulations or Schedule 3 to the LLP Regulations. [FRS102.4.2]

4.4 Each schedule specifies different formats for the order and terminology for the balance sheet. For example, Schedule 2 allows banks to present their assets in order of liquidity. Appendix II to this publication replicates Format 1 from Schedule 1 to the Regulations.

4.5 Additional line items are presented as necessary to aid users’ understanding of the entity’s financial position. [FRS102.4.3] The Companies Act requires the headings and sub-headings to be adapted when the special nature of the entity’s business requires it.

4.6 Under the Act, and therefore under FRS 102, creditors are split between amounts due within one year and amounts due after one year. If an entity does not have an unconditional right, at the period end, to defer settlement of a liability for at least 12 months after the reporting date, then that liability is classified as due within one year. [FRS102.4.7]

4.7 Debtors that are due after more than one year are required by the Regulations to be included within current assets (as defined by the Act). If this balance is sufficiently material to the financial statements it is disclosed on the face of the balance sheet within current assets, otherwise it is disclosed in the notes. [FRS102.4.4A]

4.8 Details of share capital, including the number of shares in issue, are disclosed either on the face of the balance sheet or in the notes. [FRS102.4.12] Similar information is presented for an entity without share capital, such as a partnership, including the rights and restrictions of each type of equity. [FRS102.4.13]

4.9 If a binding sale agreement for a major disposal of assets, or of a disposal group, is in place at the reporting date, a description of the assets (or disposal group) and details of the facts and circumstances of the sale are disclosed, in addition to the carrying amount of the assets (or disposal group). A disposal group is a group of assets and the liabilities associated with them that will together be sold, transferred or otherwise disposed of in a single transaction. The disposal group includes acquired goodwill allocated to it in line with paragraphs 27.20 to 27.22 of this publication.

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1 The definitions of banking and insurance entities are found in the Companies Act sections 1164 and 1165 respectively.
Statement of comprehensive income and income statement
Overview of requirements

• The statement of comprehensive income can be presented either as one or two statements, as a policy choice.

• Items of income and expenditure within the statement of comprehensive income are presented in accordance with the Companies Act profit and loss account formats. This applies even if the entity is not required to prepare accounts in accordance with the Companies Act (for example an entity that is not a company), unless the applicable legislation does not permit this.

• Other comprehensive income includes certain foreign exchange gains and losses; actuarial gains and losses; and changes in fair value of hedging instruments, property, plant and equipment, investments and intangible assets.

• The results of discontinued operations are presented separately using a columnar approach.

• Individually material items are disclosed separately.

• Extraordinary items are highly abnormal and are not expected to occur in practice.
The profit and loss account and statement of total recognised gains and losses (STRGL) cannot be presented as one combined statement under previous UK GAAP. The STRGL presents the total of recognised gains and losses (income and expense) recognised in the period that is attributable to shareholders. This statement includes both the profit or loss recorded in the profit and loss account, and gains and losses recorded elsewhere, such as movements on a revaluation reserve, unrealised foreign exchange translation differences and actuarial gains and losses on defined benefit pension schemes. If there are no recognised gains or losses other than the profit or loss for the year, an entity can make a statement to this effect and is not required to present a separate STRGL. The STRGL is broadly equivalent to the statement of comprehensive income when a two-statement approach is taken under FRS 102, except that the amounts included in the STRGL do not include amounts attributable to minority interests (non-controlling interests).

The definition of discontinued operations under FRS 3 differs from that under FRS 102. It includes not only operations that are sold or terminated in the period, but also those that are sold or terminated before the earlier of three months after the end of the reporting period and the date the financial statements are approved. In addition, under FRS 3, the sale or termination must have a material effect on the nature and focus of the entity’s operations, representing a material reduction in operating facilities. For example, an operation disposed of two months after the year end, before the financial statements are approved, would be classified as discontinued under FRS 3 (assuming the other conditions are met). It would not meet the definition under FRS 102 as it had not been disposed of at the year end.

Under FRS 3, interest and taxation charges/credits are not required to be analysed between continuing and discontinued operations, whereas FRS 102 requires an analysis to be given to the profit after tax level. Only the analysis of turnover, operating profit, and ‘paragraph 20’ exceptional items (see paragraph pUK5.6 of this publication) is required to be shown on the face of the profit and loss account under FRS 3, that permits the remaining analysis to be included in the notes to the financial statements.

FRS 3 requires analysis on the face of the profit and loss account of the results of acquisitions in the period.

FRS 3 requires the presentation of ‘operating profit’, that is usually profit before income from shares in group undertakings.

FRS 3 has the concept of ‘exceptional items’ that are material items resulting from ordinary activities that, due to their size or incidence, require separate disclosure in order for the financial statements to give a true and fair view. The separate disclosure is on the face of the profit and loss account if that degree of prominence is required for a true and fair view. Otherwise an entity may choose to present exceptional items on the face of the profit and loss account or only in the notes. Three types of exceptional item (so-called ‘paragraph 20’ items) are required to be presented outside operating profit or loss: the profit or loss on sale of an operation; fundamental restructuring costs; and the profit or loss on disposal of fixed assets.

FRS 3 contains a requirement for a note of historical cost profits and losses to be presented when there is a material difference between the result as disclosed in the profit and loss account and the result on an unmodified historical cost basis.

Under FRS 3 the cumulative effect of prior period adjustments is noted at the foot of the current year STRGL.

Previous UK GAAP also requires the profit and loss account to be presented in accordance with the Companies Act formats so this is not a GAAP differences for companies. For other entities, the Companies Act formats will apply under FRS 102 whereas they were not mandated under previous UK GAAP. Appendix IV to FRS 102 details other legal frameworks and the Accounting Council does not believe the formats required by these frameworks are inconsistent with FRS 102.
An entity has a choice whether to present total comprehensive income for the period in one statement (a statement of comprehensive income) or two statements (an income statement, also known as a profit and loss account, and a statement of comprehensive income). A change from presenting one statement to two (or vice versa) is a change in accounting policy and is accounted for as such. Accounting policies are discussed in Chapter 10 of this publication.

In the one-statement approach all items of income and expense recognised in the period are included in the statement of comprehensive income. Under the two-statement approach, the income statement includes all items of income and expense recognised in the period other than those recognised outside profit or loss. Under the Companies Act usually only realised profits are included in profit or loss. Nevertheless, movements in the fair values of financial instruments, investment properties or living animals or plants may be recognised in profit or loss under the Companies Act; entities may wish to record such amounts in a separate non-distributable reserve within equity.

Items of other comprehensive income (OCI) that are recognised outside profit or loss as part of total comprehensive income include:

- foreign exchange component of a gain or loss on a non-monetary item when the gain or loss itself has been recognised in OCI (for example, any foreign exchange component of actuarial gains and losses or of the revaluation of property, plant and equipment, see below); [FRS102.30.11]
- foreign exchange differences on a net investment in a foreign operation in the financial statements that include the foreign operation and the reporting entity; [FRS102.30.13]
- foreign exchange differences on translating assets, liabilities, income and expenses from a functional currency to the presentational currency; [FRS102.30.18(c)]
- remeasurement of a defined benefit pension liability, i.e. actuarial gains and losses, and the return on plan assets excluding the amount included in net interest; [FRS102.28.23(d), FRS102.28.25]
- the effective portion of the change in the fair value of hedging instruments when the hedged risk is variable interest rate risk, foreign exchange risk or commodity price risk in a firm commitment or highly probably forecast transaction, or (in consolidated financial statements) a net investment in a foreign operation; [FRS102.12.23]
- changes in fair values of investments in subsidiaries, associates and joint ventures when the parent has made the accounting policy election to account for its investments in subsidiaries, associates and joint ventures at fair value with changes in fair value recognised in accordance with paragraphs FRS 102.17.15E and FRS 102.17.15F (see following bullet), [FRS102.28.23(d), FRS102.28.25]
- when the revaluation model is selected for the measurement of property, plant and equipment, heritage assets or intangible assets, revaluation increases and decreases are generally recognised in OCI; [FRS102.17.15E-F, FRS102.30.49, FRS102.18.18G-H]
- the movements in fair value of available-for-sale assets when an entity chooses under FRS 102.11.2 to apply IAS 39 for the recognition and measurement of its financial instruments.

### One-statement approach

In its statement of comprehensive income an entity includes the profit and loss account items in line with Part 1 General Rules and Formats of one of the following:

(a) Schedule 1 to the Regulations (applies to all entities other than those applying (b), (c), or (d), unless legislation specific to the entity requires a different format; see paragraph 1.12 of this publication);

(b) Schedule 2 to the Regulations (applies to banking entities);

(c) Schedule 3 to the Regulations (applies to insurance entities);

(d) Schedule 1 to the LLP Regulations (applies to LLPs). [FRS102.5.5]
Applicable standards: IAS 1, IAS 8, IFRS 5

IFRS5.1  Under EU-IFRS there is no definition of an extraordinary item. This classification is not used.

IFRS5.2  For entities applying EU-IFRS there is no prohibition on recognising unrealised profits in the income statement.

IFRS5.3  The definition of discontinued operation under IFRS 5 includes a component of an entity that is classified as held for sale at the reporting date. This is not included in the FRS 102 definition.

IFRS5.4  Under IFRS 5 the analysis of the results of a discontinued operation may be presented in the notes to the financial statements. Under FRS 102 this is presented on the face of the statement of comprehensive income (or income statement if presented) together with a total column. No total column is required under EU-IFRS.
5.5 A group profit and loss account is presented in line with Schedule 6 to the Regulations or Schedule 3 to the LLP Regulations. [FRS102.5.5]

5.6 Each schedule specifies different formats for the order and terminology for the profit and loss account. For example, Format 1 in Schedule 1 to the Regulations presents expenses by function and Format 2 presents them by nature. Appendix II to this publication replicates Formats 1 and 2 from Schedule 1 to the Regulations.

5.7 Under this approach an entity includes in the single statement:
(a) other than amounts in (b), each item of OCI for the period as per paragraph 5.3 of this publication, analysed by nature and shown either net of tax or before tax with the aggregate tax shown for all components of OCI;
(b) its share of OCI of associates and jointly controlled entities for the period; and
(c) total comprehensive income for the period. [FRS102.5.5A]

5.8 Comprehensive income, and profit or loss for the period, are allocated between any non-controlling interests and the owners of the parent. [FRS102.5.6] In practice this is applicable only to consolidated financial statements.

**Two-statement approach**

5.9 Under the two-statement approach an entity presents the following statements:
(i) an income statement (profit and loss account) in the format described in paragraph 5.4 of this publication; [FRS102.5.7] and
(ii) a statement of comprehensive income, which has the profit or loss for the period as its first line and presents the items of OCI for the period as described in paragraphs 5.7 of this publication. [FRS102.5.7B]

5.10 As with the single statement approach, profit or loss for the period and comprehensive income for the period are analysed between that attributable to:
- non-controlling interests; and
- owners of the parent. [FRS102.5.7A-B]

**Requirements applicable under both approaches**

**Discontinued operations**

5.11 Discontinued operations are defined as a component of an entity that has been disposed of and that:
(a) represented a separate major line of business or geographical area of operations;
(b) was part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
(c) was a subsidiary acquired exclusively with a view to resale. [FRS102.GL]

5.12 The post-tax profit or loss of a discontinued operation is presented on a line-by-line basis in a separate ‘discontinued operations’ column on the face of the profit and loss account (or statement of comprehensive income if the one-statement approach is taken). This column will also include the post-tax gain or loss on disposal or impairment of the discontinued operation. This column is given in addition to ‘continuing operations’ and a ‘total’ column is also disclosed. An illustration of this is included in the appendix to Section 5 Statement of comprehensive income and income statement. [FRS102.5.7B] Prior period comparatives are similarly presented for all operations discontinued by the end of the current reporting period. [FRS102.5.7D-E]

**Other requirements applicable under both approaches**

5.13 As a minimum the amount of turnover is presented on the face of the profit and loss account (or statement of comprehensive income if the one-statement approach is taken). [FRS102.5.7C]

5.14 The correction of material errors and changes in accounting policy are accounted for as retrospective adjustments to prior periods in accordance with Section 10 Accounting policies, estimates and errors. [FRS102.5.8]
5.15 Additional line items, headings and sub-headings are presented when relevant to aid the understanding of the financial statements. [FRS102.5.9] Items are presented separately when material. [FRS102.5.9A] The Companies Act requires the headings and sub-headings to be adapted when the special nature of the entity’s business requires it.

5.16 Operating profit is not required to be disclosed. When the results of operating activities are disclosed, this represents activities normally considered to be operating. This would include items such as inventory write-downs, restructuring costs and other operating items, even if they occur infrequently. [FRS102.5.9B]

5.17 Ordinary activities are activities that are undertaken as part of an entity’s business and related activities. This includes political, regulatory, economic and geographical effects, regardless of the frequency or unusual nature of events. [FRS102.5.10]

5.18 Extraordinary items are material transactions or events with a high degree of abnormality that arise outside ordinary activities. They are not expected to recur. Extraordinary items do not include any additional line item, headings or sub-headings presented as a result of paragraph 5.15 of this publication. Extraordinary items are not expected to be seen in practice. [FRS102.5.10A]

5.19 An analysis of expenses is presented based on either their nature or function, whichever is more relevant and reliable for that entity, unless the Regulations require otherwise. Classification by nature (as presented in Format 2, see paragraph 5.6 of this publication) involves aggregating expenses according to their nature (e.g. depreciation, staff costs). Analysis by function (as presented in Format 1, see paragraph 5.6 of this publication) involves aggregation of expenses according to their function (e.g. cost of sales, distribution costs, administrative expenses).
Statement of changes in equity and statement of income and retained earnings
Overview of requirements

• A separate statement of changes in equity is required if changes to equity arise from items other than profit or loss, payment of dividends, corrections of prior period material errors or changes in accounting policy.

• Otherwise, a combined statement of income and retained earnings can be presented instead of separate statements of comprehensive income and of changes in equity.
### vs previous UK GAAP

**Applicable standards:** FRS 3, FRS 28

**pUK6.1** Under FRS 3 a reconciliation of movements in shareholders’ funds is presented as a note to the financial statements or adjacent to the other primary statements. This statement pulls together the results of the entity as presented in the profit and loss account and the statement of total recognised gains and losses, and other changes in shareholders’ funds arising from transactions with shareholders, such as dividend payments, the issue of share capital and capital contributions. Unlike in FRS 102, the statement does not reconcile total equity (including non-controlling interests): it presents shareholders’ funds, which exclude minority interest. Previous UK GAAP also requires the reconciliation from opening to closing balance on each reserve to be given in a note, although unlike FRS 102 there is no requirement for comparative movements.

### vs EU-IFRS

**Applicable standards:** IAS 1, IAS 8

**IFRS6.1** IAS 1 does not include any exemption from presenting a separate statement of changes in equity.

**IFRS6.2** IAS 1 requires greater disclosure on dividends and the related amount per share.

**IFRS6.3** EU-IFRS has less guidance on the presentation of reserves. The Companies Act (and therefore UK GAAP) has specific requirements regarding this presentation, e.g. share capital, share premium, capital redemption reserve.
FRS 102
Section 6

Statement of changes in equity

6.1 The statement of changes in equity presents the following information:

- total comprehensive income for the period. For consolidated accounts this is split between the amount that is attributable to the owners of the parent and that attributable to any non-controlling interest;
- for each component of equity, the effect of a retrospective application or restatement resulting from a change in accounting policy or correction of prior period material error; and
- for each component of equity, a reconciliation between the carrying amount at the beginning and end of the period disclosing separately:
  - profit or loss;
  - other comprehensive income (with an analysis of each item shown either in the statement of changes in equity or in the notes);
  - investments by owners (including disclosing separately the issue of shares and purchase of own share transactions);
  - dividends and other distributions to owners; and
  - changes in ownership interests in subsidiaries that do not result in a loss of control. [FRS102.6.3]

Statement of income and retained earnings

6.2 When the only changes in equity in addition to profit or loss for the period are those listed in paragraph 6.3 of this publication, an entity can choose to present a single statement of income and retained earnings in place of separate statements of comprehensive income and of changes in equity.

6.3 The statement of income and retained earnings presents the income statement information required by Section 5 Statement of comprehensive income and income statement and the following items:

- retained earnings at the beginning of the reporting period;
- dividends declared and paid or payable in the period;
- restatements for corrections of prior period material errors or changes in accounting policy; and
- retained earnings at the end of the reporting period. [FRS102.6.5]
Statement of cash flows
Overview of requirements

- Qualifying group entities are not required to present a cash flow statement in their individual financial statements.

- Cash flows are presented in the statement of cash flows classified by operating, investing and financing activities.

- Net cash flows from all three categories are totalled to show the change in cash and cash equivalents during the period. Opening cash and cash equivalents is reconciled to the closing amount.

- Cash and cash equivalents includes certain short-term investments and, in some cases, bank overdrafts.

- Cash flows from operating activities may be presented using either the direct or indirect method.

- Generally all financing and investing cash flows are reported gross.

- Foreign currency cash flows are translated at the exchange rates at the dates of the cash flows, or at a rate that approximates to this (e.g. a weighted average rate).
FRS 1 has a narrower definition of cash than FRS 102 with no concept of ‘cash equivalents’, which generally would be classified as ‘liquid resources’ under FRS 1. Movements in ‘liquid resources’ are shown separately in the cash flow statement.

FRS 1 is generally more prescriptive on the classification of cash flows. The cash flow statement presents cash flows in the period classified under nine headings: cash flows from operating activities, dividends from joint ventures and associates, returns on investments and servicing of finance, taxation, capital expenditure and financial investment, acquisitions and disposals, equity dividends paid, management of liquid resources and financing. Under FRS 1, further analysis of each of these main headings in the cash flow statement may be presented on the face or in the notes.

FRS 1 requires supplementary disclosures in addition to the cash flow statement, being:
(a) reconciliation from operating profit to net cash flow from operating activities;
(b) reconciliation of movement in cash in the period to the movement in net debt; and
(c) analysis of changes in net debt.

The reconciliations in pUK7.3(a) and (b) do not form part of the cash flow statement but each may be given either adjoining the statement or in a separate note. The analysis of changes in net debt in pUK7.3(c) is given in a note. The concept of ‘net debt’ does not exist under FRS 102.

When applying the indirect method under FRS 1 the reconciliation to operating cash flow starts at operating profit. In contrast, FRS 102 refers to profit or loss for the period.

Under FRS 1, the exemption from preparation of a cash flow statement for subsidiary undertakings applies only to those for which 90 percent or more of the voting rights are controlled within the group, provided that consolidated financial statements in which those subsidiary undertakings are included are publicly available. The definition of a qualifying entity under FRS 102 does not include a minimum ownership threshold. Under FRS 1, in the individual financial statements of a parent that prepares consolidated financial statements, a cash flow statement for the parent as an individual entity is commonly not presented.

Under FRS 1, small entities are not required to present a cash flow statement. No such exemption is available under FRS 102, although such entities could choose to apply the FRSSE.

The scope exemption for investment funds under FRS 1 is restricted to ‘open-ended’ investment funds.
Scope

7.1 A qualifying entity (refer to paragraph 1.22 of this publication for definition) applying the reduced disclosure framework under FRS 102 may elect not to include a statement of cash flows in its individual financial statements. [FRS102.1.12(b)] When the appropriate conditions for this exemption are met, it is available to the ultimate parent company as well as subsidiaries that are consolidated into publicly available accounts.

7.2 The following entities are not required to present a cash flow statement:
- mutual life assurance companies;
- retirement benefit plans; and
- investment funds when substantially all of their investments are highly liquid investments carried at market value and a statement of changes in net assets is presented. [FRS102.7.1A]

Cash and cash equivalents

7.3 Cash includes cash on hand and demand deposits. [FRS102.GL] Cash equivalents are short-term highly liquid investments with an insignificant risk of their value changing, and that are readily convertible to a known amount of cash. ‘Short-term’ is normally considered to be three months or less from the date of acquisition.

7.4 Bank overdrafts that are repayable on demand and form an integral part of an entity’s cash management are treated as a component of cash and cash equivalents. Otherwise they are considered to be financing activities. [FRS102.7.2]

7.5 A reconciliation is presented between cash and cash equivalents in the cash flow statement to the equivalent items in the balance sheet, if they are not identical. [FRS102.7.20] Entities applying Schedule 2 to the Regulations (i.e. banks) include only cash and balances at central banks and loans and advances to banks repayable on demand in their cash balance (see paragraph 4.2 of this publication). [FRS102.7.20A]

Operating, investing and financing activities

7.6 Cash flows are classified into those relating to operating activities, investing activities and financing activities. [FRS102.7.3]

(a) Operating activities are the principal revenue-producing activities of the entity. Cash flows from operating activities generally relate to amounts recognised in profit or loss that are not investing or financing cash flows. [FRS102.7.4]

(b) Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. [FRS102.7.5] They include cash flows arising from the acquisition and disposal of property, plant and equipment and subsidiaries or other business units.

(c) Financing activities relate to the equity and borrowings of an entity. [FRS102.7.6]

7.7 Major classes of gross cash receipts and payments arising from investing and financing activities are required to be presented separately except when net presentation is allowed (see next paragraph). [FRS102.7.10]

7.8 Cash receipts and payments may be presented net when:
- they are made on behalf of customers and reflect the customer’s activities, not those of the entity, e.g. rents collected on behalf of, and paid over to, the owners of properties; [FRS102.7.10A,B]
- the turnover of the related items is quick, the amounts are large, and the maturities are short e.g. purchase and sale of investments; [FRS102.7.10A,C] or
- the entity is a financial institution, and the cash flows are listed in FRS 102.34.33 (see paragraph 34D.6 of this publication). [FRS102.7.10D]

7.9 A financial institution that effects or carries out insurance contracts includes the cash flows of its long-term business only to the extent of cash transferred and available to meet the obligations of the entity or group as a whole. [FRS102.7.10E]

7.10 Cash flows from hedging contracts are classified in the same manner as the cash flows of the item being hedged. [FRS102.7.5]
<table>
<thead>
<tr>
<th>vs EU-IFRS</th>
<th>Applicable standard: IAS 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS7.1</td>
<td>Under IAS 7 there are no disclosure exemptions. All entities are required to present a statement of cash flows.</td>
</tr>
<tr>
<td>IFRS7.2</td>
<td>The reconciliation from profit to net cash from operations is, in our view, required to be presented on the face of the statement of cash flows under IAS 7. FRS 102 is silent on whether the reconciliation from profit or loss to net operating cash flow is presented on the face or in the notes.</td>
</tr>
</tbody>
</table>
**Direct vs indirect method**

7.11 There is a choice of presenting cash flows from operating activities using either:
   (a) the indirect method, when profit or loss is reconciled to net cash from operations; or
   (b) the direct method, when major classes of gross cash receipts and payments are disclosed. [FRS102.7.7]

7.12 We expect that most entities will continue to apply the indirect method.

**Foreign exchange differences**

7.13 Cash flows arising from an entity’s foreign currency transactions are translated into its functional currency at the exchange rate at the date of the cash flow or an approximate exchange rate, for example a weighted average rate for the period. [FRS102.7.11] Cash flows of foreign subsidiaries are translated at the exchange rate at the dates of the cash flows or an exchange rate that approximates the actual e.g. a weighted average. [FRS102.7.12]

7.14 Unrealised foreign exchange gains and losses are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is presented in the statement of cash flows. The resulting unrealised gain or loss is presented separately from cash flows from operating, investing and financing activities as part of the reconciliation of movement in cash and cash equivalents. [FRS102.7.13]

**Interest and dividends**

7.15 Cash flows from interest and dividends received and paid are presented separately. [FRS102.7.14] Cash flows from interest and dividends received can be classified as either operating or investing activities. [FRS102.7.15] Cash flows from interest and dividends paid can be classified as either operating or financing activities. [FRS102.7.16] The classification adopted is applied consistently from period to period.

**Income tax**

7.16 Cash flows arising from income tax are classified as operating activities unless they can be specifically identified with financing and investing activities. If they are split, the total paid is also disclosed. [FRS102.7.17]

**Non-cash transactions**

7.17 Investing and financing transactions that do not require the use of cash or cash equivalents (for example, the conversion of debt to equity, or the acquisition of assets under a finance lease) are excluded from the statement of cash flows but are disclosed elsewhere in the financial statements. [FRS102.7.18]

**Disclosures**

7.18 Disclosure is made of the amount of cash and cash equivalent balances that are not available for use by the entity. This may be due to, for example, foreign exchange controls or legal restrictions. [FRS102.7.21]

7.19 Qualifying entities applying FRS 102 are exempt from presenting a cash flow statement in their individual financial statements. See paragraph 3.7 of this publication.
Notes to the financial statements
Overview of requirements

• The notes to the financial statements provide additional information, narrative descriptions and disaggregations of items presented in the primary financial statements, and information on items not recognised in the primary financial statements.

• Judgements and uncertainty over estimates are disclosed in the notes.
vs previous UK GAAP
Applicable standards: FRS 18, FRS 28

pUK8.1 There are no specific requirements under previous UK GAAP for disclosure of critical judgements.

vs EU-IFRS
Applicable standards: IAS 1, IAS 8

IFRS8.1 IAS 1 requires disclosure of the sensitivity of carrying amounts to the methods, assumptions and estimates applied in the financial statements.
8.1 The notes to the financial statements provide additional information, narrative descriptions, and disaggregations of items presented in the primary financial statements together with information about items that did not qualify for recognition in the financial statements. [FRS102.8.1] This will include:

- a statement of compliance with FRS 102;
- a summary of significant accounting policies (including the measurement bases used to prepare the financial statements and other accounting policies relevant to users’ understanding);
- other supporting information for items presented in the primary financial statements;
- any information that is not presented elsewhere and is required to be given by FRS 102 or is necessary for an understanding of the financial statements. [FRS102.8.4]

8.2 Each section of FRS 102 sets out required disclosures that are generally presented in the notes.

8.3 Disclosure is required of judgements (other than those involving estimates) made by management in applying accounting policies that have a significant effect on the financial statements. [FRS102.8.6] Examples of such judgements include:

- commission revenue: determination of whether the entity acts as agent or principal;
- classification of property as investment property;
- accounting for an arrangement containing a lease; and
- lease classification.

8.4 Information about key sources of estimation uncertainty is also disclosed when there is a significant risk of the uncertainty resulting in a material adjustment to the carrying amounts of assets or liabilities in the next financial year. In this case, the nature and carrying amount of the assets or liabilities affected is disclosed. [FRS102.8.7] Examples of estimates include:

- key assumptions used in discounted cash flow projections;
- recovery of development costs;
- utilisation of tax losses;
- measurement of defined benefit obligations; and
- provisions and contingencies.

8.5 In terms of their structure, the notes are presented on a systematic basis and cross-referenced from the primary financial statements as necessary. [FRS102.8.3]
Consolidated and separate financial statements
Overview of requirements

- A parent (an entity with subsidiaries) presents consolidated financial statements unless it meets one of the exemptions in the Companies Act.

- A parent not subject to the Companies Act applies the requirements of Section 9 unless it is not permitted to do so under its legal framework. If that framework does not require the preparation of consolidated financial statements, the entity is exempt from the requirement to prepare them.

- A subsidiary is an entity controlled by the parent. Control is the power to govern the operating and financial policies of an entity so as to obtain benefits from its activities. Control is presumed to exist when the parent owns more than half of the voting power of an entity.

- A special purpose entity (SPE) is an entity created for a narrow objective. FRS 102 sets out a number of factors to take into account in determining whether a parent has control of an SPE.

- Consolidated financial statements provide information about a group (a parent and all of its subsidiaries) as a single economic entity, combining the financial statements of the parent and subsidiaries on a line-by-line basis using uniform accounting policies. Investments in subsidiaries, the parent’s proportion of equity and intra-group transactions and balances are eliminated.

- A subsidiary’s financial statements used to prepare the consolidated financial statements usually have the same reporting date as the parent. If a subsidiary’s reporting date is different, financial statements made up to an earlier date may be used but only if that date is no more than three months before the parent’s period end.

- Any non-controlling interest in the balance sheet is presented separately within equity. Any non-controlling interest in the profit or loss for the year is disclosed separately in the statement of comprehensive income.

- Subsidiaries are included in the consolidation from the date of acquisition to the date the parent ceases to control the subsidiary.

- Any gain or loss on disposal of a subsidiary is recognised in profit or loss. The gain or loss does not include the cumulative amount of any exchange differences previously recognised in equity.

- Separate, or individual, financial statements are those in which investments in subsidiaries, associates or jointly controlled entities are carried at cost less impairment or fair value.
vs previous UK GAAP
Applicable standards: FRS 2, FRS 5, UITF 31, UITF 32, UITF 38

pUK9.1 Under FRS 2, when a subsidiary is excluded from consolidation on the basis that it is held exclusively with a view to resale it is recognised in the consolidated financial statements as a current asset at the lower of cost and net realisable value.

pUK9.2 When a parent increases its controlling interest in a subsidiary, FRS 2 requires the identifiable assets and liabilities of the subsidiary to be revalued to fair value, with any revaluation uplift being credited to the revaluation reserve, and incremental goodwill is calculated.
Interaction of FRS 102 and law

9.1 FRS 102 does not prescribe which entities prepare financial statements and preparers subject to the Companies Act apply the Companies Act’s requirements to determine whether financial statements (either individual or consolidated or both) are required. Section 399 of the Companies Act requires a parent company (as defined by the Companies Act) that is not subject to the small companies regime to prepare group accounts unless it qualifies for an exemption under sections 400, 401, or 402. Other companies (i.e. those that are small or qualify for one of the exemptions) are permitted to prepare consolidated accounts if they wish to do so. [FRS102.9.1]

9.2 In some cases, the requirements of FRS 102 may be inconsistent with the Companies Act. For example, FRS 102.9.9B(a) requires a group to measure certain subsidiaries held as part of an investment portfolio that are excluded from consolidation by virtue of FRS 102.9.9(b) at fair value through profit or loss. The measurement at fair value through profit or loss is a departure from the requirements of the Companies Act and the true and fair override will need to be invoked. [FRS102.ACA.51] See paragraph 3.55 of this publication.

9.3 When a parent entity does not report under the Companies Act, it follows the requirements of this chapter except to the extent that these requirements are prohibited under its statutory framework. If that framework does not require the preparation of consolidated financial statements, then the entity is exempt from the requirement to prepare them. [FRS102.9.3(g)]

Requirement to present consolidated accounts

9.4 The requirements in the Companies Act to prepare group accounts are largely mirrored in FRS 102, which states that consolidated financial statements (group accounts in the Companies Act) are prepared by all parent entities unless one of the following exemptions, that are derived from the Companies Act, applies:

- The parent company is subject to the small companies regime (see sections 383 to 384 of the Companies Act).
- The parent company is a subsidiary included in a larger group that prepares consolidated financial statements and meets the requirements of sections 400 or 401 of the Companies Act, including:
  (a) The parent is itself a subsidiary (wholly-owned or meeting the conditions of section 400(1)(b) – allowing minorities to require consolidated financial statements) whose immediate parent is established in an EEA state, and whose results are consolidated into the group financial statements of an undertaking established in an EEA state (not necessarily the immediate parent). Section 400 sets out further conditions for this exemption, including that a company that has any of its securities admitted to trading on a regulated market in an EEA state is not eligible for this exemption.
  (b) The parent is itself a subsidiary (wholly-owned or meeting the conditions of section 401(1)(b)), its immediate parent is not established in an EEA state, and its results are consolidated into the group accounts of an undertaking (either the same parent or another) drawn up in accordance with the EU Seventh Directive or in an equivalent manner (e.g. EU-IFRS accounts, see paragraphs 1.18 to 1.20 of this publication). Section 401 sets out further conditions for this exemption, including that a company that has any of its securities admitted to trading on a regulated market in an EEA state is not eligible for this exemption.
- All of the parent’s subsidiaries are excluded from consolidation under FRS 102.9.9 (see paragraph 9.6 of this publication). [FRS102.9.3]

9.5 If an entity is not a parent at the year end then it is not required to prepare consolidated accounts. [FRS102.9.2]

Exclusion of subsidiaries from consolidation

9.6 Consolidated financial statements provide information about the group as a single economic entity. They include all subsidiaries of the parent except those excluded on one of the following grounds:

(a) severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary. These rights are the rights held by or attributed to the company in the absence of which it would not be the parent company (see Companies Act section 405(4)); or

(b) the subsidiary is held exclusively for resale and has not previously been included in the consolidation. [FRS102.9.9]
IFRS9.1 If, on acquisition, a subsidiary meets the criteria to be classified as held for sale under IFRS 5, it is accounted for at the lower of cost and fair value and presented as a disposal group held for sale.

IFRS9.2 Under IFRS 3, non-controlling interests are recognised initially either at fair value or at the proportionate share of the net assets, as a transaction-by-transaction choice. The second alternative is consistent with the initial measurement of non-controlling interests under FRS 102.

IFRS9.3 On disposal of a foreign subsidiary, the cumulative foreign exchange differences relating to that subsidiary previously recognised in equity are recycled to profit or loss.

IFRS9.4 Investments in subsidiaries, associates or jointly controlled entities in separate financial statements are measured either at cost or in accordance with IAS 39.

IFRS9.5 There are no separate provisions for intermediate payment vehicles in IFRS.

Forthcoming requirements

IFRS9.6 IFRS 10 was released in May 2011 (together with the related disclosure standard, IFRS 12) and is effective in the EU from 1 January 2014. IFRS 10 replaces the definition of control in IAS 27 and SIC-12. In doing so, it introduces a fundamentally different way of assessing control for (in the main) SPEs. In addition, the new standard introduces a number of new concepts that are taken into account in assessing control. As such, it will also alter the consolidation conclusion for some entities that were previously analysed for control using IAS 27. Whilst the precise effect of applying IFRS 10 is still being assessed by many companies, it is likely that there will be a number of differences between the entities that are consolidated when applying IFRS 10 and FRS 102. It remains to be seen whether, at a future date, FRS 102 will be updated to reflect the requirements of IFRS 10.
9.7 A subsidiary excluded from consolidation due to severe long-term restrictions is, if the parent still exercises significant influence, equity accounted and treated as an associate (see Chapter 14). Otherwise, the parent has an accounting policy choice to measure the subsidiary either at cost less impairment, or at fair value through other comprehensive income (OCI) with movements below cost recorded in profit or loss (see paragraph 17.18 of this publication), or at fair value through profit or loss. [FRS102.9.9A,26]

9.8 A subsidiary that has not previously been included in the consolidation is held exclusively for resale if:
(a) a buyer has been identified or is being sought, and it is reasonably expected to be disposed of within approximately one year of its date of acquisition; or
(b) it was acquired as a result of the enforcement of a security (e.g. seized collateral), unless the subsidiary has become part of the continuing activities of the group or the holder acts as if it intends to become so; or
(c) it is held as part of an investment portfolio. [FRS102.GL]

9.9 A subsidiary is held as part of an investment portfolio if it is not held as a means through which the investor carries out business activities but, instead, its value to the investor is through its fair value as part of a directly or indirectly held basket of investments. When an investment fund holds an investment in another fund that itself holds a basket of investments, the basket of investments is said to be held indirectly. [FRS102.GL]

9.10 A subsidiary excluded from consolidation on the basis of not previously having been consolidated and being held exclusively for resale is accounted for in accordance with FRS 102.9.26, that gives an accounting policy choice of either cost less impairment, fair value through OCI with movements below cost recorded in profit or loss (see paragraph 17.18 of this publication), or fair value through profit or loss unless it is held as part of an investment portfolio. If it is held as part of an investment portfolio, it is held at fair value through profit or loss. [FRS102.9B]

9.11 Section 405 of the Companies Act states that a subsidiary may be excluded from consolidation if the necessary information to prepare the group accounts cannot be obtained without disproportionate expense or undue delay. FRS 102, however, states that this does not justify non-consolidation, effectively closing off the statutory option. [FRS102.9.8A]

9.12 Subsidiaries are not excluded from consolidation because the subsidiary has dissimilar business activities to the rest of the group. [FRS102.9.8]

Control

9.13 A subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. [FRS102.9.4]

9.14 If a parent owns more than half of the voting power of an entity either directly or indirectly through subsidiaries, it is presumed to have control of the entity. That presumption is overcome only in exceptional circumstances in which it can be clearly demonstrated that having such ownership does not give control. [FRS102.9.5]

9.15 Control also exists when the parent does not own more than half of the voting power of an entity but has power:
(a) over more than half of the voting rights under an agreement with other investors;
(b) to govern the financial and operating policies of the entity under law or other agreement;
(c) to appoint or remove the majority of the members of the governing body; or
(d) to cast the majority of votes at meetings of the governing body. [FRS102.9.5]

9.16 Holding options or convertible instruments that are currently exercisable may also give rise to control. Control can also be achieved if a party has an agent with the ability to direct the activities for the benefit of that party. [FRS102.9.6]

9.17 Control can also exist when the parent and undertaking are managed on a unified basis, or when the parent has the power to exercise or actually exercises dominant influence or control. [FRS102.9.6A]
Special purpose entities (SPEs)

9.18 An SPE is an entity created for a narrow objective (e.g. to effect a lease, undertake research and development activities, securitise financial assets or facilitate employee shareholdings under remuneration schemes, such as Employee Share Ownership Plans (ESOPs)). It may take the form of a corporation, trust, partnership or unincorporated entity and is often created with legal arrangements that impose strict requirements over its operations. [FRS102.9.10]

9.19 The following factors (amongst others) may indicate control of an SPE (i.e. that the SPE is a subsidiary):

(a) the activities of the SPE are conducted on behalf of the entity according to its specific business needs;
(b) the entity has the ultimate decision-making powers over the activities of the SPE even if the day-to-day decisions have been delegated;
(c) the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; and
(d) the entity retains the majority of the residual or ownership risks related to the SPE or its assets. [FRS102.9.11]

9.20 However, post-employment and other long-term employee benefit plans to which Section 28 Employee benefits applies are scoped out of the above requirements and so are not liable to consolidation. Employee share ownership plan trusts and similar plans related to share-based payment arrangements are outside the scope of Section 28 and hence are within this section. However, they are examples of intermediate payment arrangements, for which FRS 102 makes special provision as set out below. [FRS102.9.12]

Intermediate payment arrangements (IPA)

9.21 FRS 102 includes additional guidance on the accounting for some types of SPEs, known as IPAs. Assuming that the sponsoring entity obtains economic benefits from payments to the IPA and has control of its right or other access to those economic benefits, the IPA's assets, liabilities and transactions are treated as those of the sponsoring entity – i.e. brought into its individual financial statements. [FRS102.9.34,35]

9.22 FRS 102 does not define an IPA but sets out a number of features of such arrangements. These include:

(a) An IPA is usually established by a sponsor and constituted as a trust (although other arrangements are possible).
(b) Sometimes the way that an IPA is set up leaves it with little discretion in the broad nature of its activities. In other cases, whilst the sponsor may not have the ability to direct the IPA's activities, it may give advice to the IPA or provide the information that the IPA needs in order to undertake its activities.
(c) IPAs are commonly used to pay employees but may also be used to compensate suppliers. Beneficiaries of IPAs may include former employees and charities.
(d) The precise identity of the parties that will receive payment from the IPA and the amounts that they will receive are not usually agreed at the outset.
(e) The sponsoring entity often has the right to veto or appoint the IPA’s trustees (or directors).
(f) The payments made to the IPA and the payments made by the IPA are often cash. [FRS102.9.33]

9.23 Examples of IPAs include ESOPs and employee benefit trusts. [FRS102.9.33]

9.24 Since the assets, liabilities and transactions of IPAs (that meet the definition in paragraph 9.21 of this publication) are brought into the sponsor’s individual financial statements, then the fact that the IPA is a subsidiary of the sponsor is academic.

Preparation of consolidated accounts

9.25 Subsidiaries are consolidated on a line-by-line basis, eliminating the carrying amount of the parent’s investment in each subsidiary and the parent’s portion of each subsidiary’s equity. [FRS102.9.13(a),(b)]

9.26 Intra-group transactions and balances are eliminated on consolidation. However, intra-group losses may indicate the existence of an impairment that needs to be recognised in the consolidated financial statements. The deferred tax effect of the elimination of intra-group transactions is discussed in Chapter 29 of this publication. [FRS102.9.15]
Consistency of accounting policies and reporting date

9.27 The financial statements of subsidiaries included in the consolidation are prepared using the same accounting policies as those used by the group. [FRS102.9.17] The consolidated financial statements are prepared using financial statements of the parent and subsidiaries prepared as of the same reporting date. If the subsidiary’s reporting date is no more than three months before that of the parent, then the subsidiary’s financial statements may be used for the consolidation, after adjusting for significant matters occurring between the subsidiary’s reporting date and parent’s reporting date. Otherwise, interim accounts are prepared by the subsidiary to the parent’s reporting date. [FRS102.9.16]

Non-controlling interest (NCI)

9.28 NCI is defined as the equity in a subsidiary not attributable, directly or indirectly, to a parent. [FRS102.GL]

9.29 Profit or loss and each component of OCI are allocated to the owners of the parent and to NCI based on their existing ownership interests. [FRS102.9.14]

9.30 NCI in the net assets is measured and presented separately from that of the parent. [FRS102.9.13d]

9.31 NCI is presented separately in the consolidated balance sheet within equity. [FRS102.9.20] NCI in the profit or loss and total comprehensive income of the group is shown separately in the statement of comprehensive income (or income statement if presented). [FRS102.9.21] See Appendix II to this publication for where NCI is presented in common profit and loss and balance sheet formats.

9.32 NCI comprises the amount of NCI at the date of the original combination calculated in accordance with Section 19 Business combinations and goodwill and the NCI’s share of changes in equity since that date. On acquisition, the NCI is calculated as the proportionate interest in the fair value of the identifiable assets and liabilities of the acquiree. [FRS102.9.13(d)] Paragraph 22.22 of this publication discusses the accounting for changes in NCI that result from changes in the parent’s controlling interest in a subsidiary (but neither net assets nor goodwill is adjusted by the price paid/received and the change is dealt with as an equity transaction).

9.33 The possible exercise or conversion of options or convertible instruments is not taken into account when calculating the NCI’s ownership interest. There are no restrictions on net liabilities of the subsidiary resulting in the NCI having a deficit (i.e. debit) balance. [FRS102.9.14,20,22]

Disposal of subsidiaries

9.34 The results of a subsidiary are included in the consolidation from the acquisition date (see Chapter 19 of this publication) until the date the parent loses control of the subsidiary. A parent may lose control of a subsidiary by disposal of some or all of its stake, or without a change in ownership, e.g. when a subsidiary falls under the control of a government, court, administrator or regulator. [FRS102.9.18]

9.35 Any gain or loss on loss of control is recognised in profit or loss. This is calculated as the difference between:

a) the proceeds; and

b) the transaction date carrying amount of the portion of the subsidiary disposed of or lost. [FRS102.9.18A]

9.36 Items recorded in OCI, in relation to the former subsidiaries, are recycled through profit or loss if they would be recycled were the underlying assets or liabilities to which they relate disposed of directly. [FRS102.9.18A,B]

9.37 If control is lost but a NCI is retained by the group, the group accounts for this as a financial asset, an associate or a jointly controlled entity as applicable. The proportionate, retained share of the former consolidated book value of the net assets is regarded as the cost of the retained interest at the date that control is lost.

9.38 If the parent retains significant influence or joint control, the retained interest (with its cost determined as above) is accounted for in accordance with Chapter 14 or 15 respectively, except that the requirements of FRS 102.14.8(c), to make fair value adjustments in respect of the underlying assets and liabilities and to (re)calculate goodwill, do not apply. [FRS102.9.19]
Exchanges of business or other non-monetary assets for an interest in a subsidiary, jointly controlled entity or associate

9.39 The exchange of a business or other non-monetary asset for an interest in an entity which is or thereby becomes a subsidiary, jointly controlled entity or associate is accounted for in the consolidated financial statements of the parent (or investor) as follows:

(a) to the extent that the parent or investor retains an interest (direct or indirect) in the business exchanged, it is held at its pre-transaction carrying amount;

(b) goodwill is recognised as the difference between the fair value of the consideration given and the fair value of the reporting entity’s share of the pre-transaction identifiable net assets of the other entity. The consideration given includes that part of the business or cash or monetary assets exchanged that is no longer owned by the reporting entity. If this is difficult to value then the value of the assets acquired may be used as a best estimate;

(c) a gain is recognised when the fair value of the consideration received exceeds the book value of the part of the business (including any related goodwill) and any cash given up. Being unrealised this gain is recognised in OCI;

(d) a loss is recognised when the fair value of the consideration received is less than the book value of the part of the business (including any related goodwill) and any cash given up; [FRS102.9.31]

(e) no gain or loss is recognised in the rare case when the transaction lacks substance. In such a case, the circumstances are explained.

Example

Company X acquires a 60% controlling holding in company Y, that thereby becomes its subsidiary (X had no pre-existing holding), in exchange for transferring its warehouse into Y. The fair value of the warehouse is 300 and its carrying amount is 250. The fair value of Y (without the warehouse) is 200. In other words, X exchanges 40% of a warehouse, fair value 120 (40% x 300), for a 60% interest in Y, fair value 120 (60% x 200). The fair value of Y’s identifiable net assets is 180. The accounting in the consolidated financial statements of X is:

- X keeps its warehouse at its pre-transaction carrying amount of 250, but recognises NCI of 100 (40% of 250).
- X recognises the net assets of Y at 180 (fair value) plus NCI of 72 (40% x 180).
- X recognises goodwill as the difference between the fair value of a 40% interest in the warehouse, 120 (40% x 300), and its interest in the net assets of Y, 108 (180 - NCI of 72): i.e. 120 - 108 = 12.
- X records a gain on disposal (in OCI as it is unrealised) of 20, being the difference between the fair value of the consideration received for the disposal, i.e. 60% of Y (60% x 200) 120, and 40% of the book value of the warehouse, 100 being the NCI figure in the first bullet above.

- The journal entry is:

<table>
<thead>
<tr>
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<th>Dr</th>
<th>Cr</th>
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</thead>
<tbody>
<tr>
<td>Net assets</td>
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</tr>
<tr>
<td>Goodwill</td>
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<tr>
<td>NCI (100 + 72)</td>
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<td></td>
</tr>
<tr>
<td>Gain in OCI</td>
<td></td>
<td>20</td>
</tr>
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</table>

Separate financial statements

9.40 Separate financial statements are those presented by a parent, in which the investments in subsidiaries, associates or jointly controlled entities are accounted for either at cost or fair value rather than on the basis of the reported results and net assets of the investees. [FRS102.9.24]

9.41 Individual financial statements are defined by the Companies Act section 394 as accounts for the company, prepared in addition to any group accounts it might prepare if it is a parent. Separate financial statements as described in FRS 102 are an example of individual financial statements in the Companies Act. Individual financial statements are unconsolidated financial statements and ‘separate financial statements’ is the name given to the individual financial statements of an entity with investments in subsidiaries, associates or jointly controlled entities.
9.42 In individual financial statements, an entity accounts for investments in subsidiaries, associates and jointly controlled entities:

(a) at cost less impairment; or

(b) at fair value with changes recognised in OCI so long as fair value is in excess of cost and profit or loss if fair value is below cost – see paragraph 17.18 of this publication; or

(c) at fair value through profit or loss. See paragraph 11.25 of this publication for guidance on fair value. [FRS102.9.25,26]

9.43 This policy choice is applied consistently for all investments in a particular class, although different policies may be applied to each class. [FRS102.9.26]

9.44 This policy choice is available whether or not the parent prepares consolidated financial statements or is exempt from doing so. [FRS102.9.26A]
10 Accounting policies, estimates and errors
Overview of requirements

• Accounting policies are the specific principles, bases, conventions, rules and practices used by an entity to prepare its financial statements.

• A hierarchy of alternative sources is given to assist management in applying judgement to develop an appropriate accounting policy if FRS 102 does not cover a specific issue. Management may, but is not required to, consider the requirements and guidance of EU-IFRS.

• Accounting policies are applied consistently.

• Accounting policies are changed only when mandated by FRS 102 or in order to provide reliable and more relevant information.

• Changes in accounting policies are applied retrospectively, except when mandated changes have specific transitional provisions or when (unusually) retrospective application is impracticable.

• A change in accounting estimate is an adjustment to the carrying amount of an asset or liability, or useful life of an asset, that results from a change in the associated expected future benefits and obligations.

• Changes in accounting estimates result from new information or new developments and accordingly are not corrections of errors.

• Changes in accounting estimates are accounted for prospectively.

• Material prior period errors are corrected by restating the comparative amounts.
pUK10.1 Under FRS 3 fundamental prior period errors are corrected retrospectively by restating the comparatives (rather than material prior period errors as under FRS 102). A fundamental error is defined by FRS 3 as an error that is ‘of such significance as to destroy the true and fair view and hence the validity of the prior period financial statements’.

pUK10.2 Under FRS 3 the cumulative effect of prior period adjustments is noted at the foot of the current year statement of recognised gains and losses. Under FRS 102 this is not included in the statement of comprehensive income, but shown only in the statement of changes in equity.
Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements. [FRS102.10.2]

Hierarchy

When FRS 102 does not give specific guidance, judgement is used in developing an appropriate accounting policy that results in information that is relevant and reliable. The following hierarchy of alternative sources is given to assist management in applying that judgement:

(i) the requirements and guidance in FRS 102 on similar and related issues;
(ii) the requirements and guidance in an applicable Statement of Recommended Practice (SORP) on similar and related issues;
(iii) the definitions, recognition criteria, measurement concepts and pervasive principles in Section 2 Concepts and pervasive principles. [FRS102.10.5]

Management may also, but is not required to, consider the requirements and guidance of EU-IFRS on similar and related issues. Entities apply IAS 33, IFRS 6 or IFRS 8 when required to do so. [FRS102.1.3-7, FRS102.10.6]

Consistency

Accounting policies are applied consistently. If FRS 102 or another FRS or FRC Abstract specifically requires or permits items to be divided into separate categories for which different policies may be appropriate, then the policy is applied consistently within each category. [FRS102.10.7]

Changes to accounting policies

Accounting policies may be changed only if required by changes to FRS 102, another applicable FRS or FRC Abstract, or if the change results in reliable and more relevant information. [FRS102.10.8]

The introduction of accounting policies for new transactions or transactions that differ in substance from those occurring previously does not constitute a change in accounting policy. This is also the case for a change to the cost model when a reliable measure of fair value is no longer available (or vice versa) when fair value accounting is either required or permitted under FRS 102. [FRS102.10.9]

When FRS 102 allows a choice of accounting treatment a change in this treatment is a change in accounting policy. [FRS102.10.10]

However, the initial decision to revalue assets is a revaluation in line with Section 17 Property, plant and equipment or Section 18 Intangible assets other than goodwill (and is therefore accounted for in the period of the revaluation) rather than a change in accounting policy to be accounted for as described in the paragraph below. [FRS102.10.10A]

When a change in accounting policy is mandated by a change in the requirements of FRS 102, the transitional provisions included in that new requirement take precedence. If the entity has elected to follow IAS 39 and/or IFRS 9 rather than Section 11 Basic financial instruments and Section 12 Other financial instruments issues and there is a change to that standard, then the transitional provisions for the change in that standard are applied. Similarly, when an entity has elected to follow IAS 33, IFRS 6 or IFRS 8 and the requirements of those standards change, an entity follows any specified transitional provisions given in those standards. For all other changes, the change is applied retrospectively by restating prior periods unless it is impracticable to determine the effect on individual prior periods. The entity makes every reasonable effort to apply the change retrospectively before concluding that it is impracticable to do so. When restatement is impracticable, the change in policy is applied prospectively from the start of the earliest period practicable (which may be the current period), with a corresponding adjustment to the opening balance of each affected component of equity. [FRS102.10.11]

Disclosure is made of the nature and effect of the change in accounting policy on both the current and prior periods. [FRS102.10.13]
vs EU-IFRS
Applicable standards: IAS 1, IAS 8

IFRS10.1 Under EU-IFRS, the hierarchy of guidance to consider in the absence of specific requirements includes pronouncements issued by other standard-setting bodies or industry practice as a source. These sources are not included in FRS 102, except for industry practice that is documented in a Statement of Recommended Practice (SORP).

IFRS10.2 A statement of financial position as at the beginning of the earliest comparative period is presented when an entity restates comparative information following a change in accounting policy, correction of an error, or reclassification of items in the financial statements.
Changes in accounting estimates

10.11 A change in accounting estimate is a change in the carrying amount, expected useful life or usage pattern of an asset or liability resulting from a reassessment of the expected future benefits and obligations associated with the assets and liabilities.

10.12 New information or developments that result in changes to accounting estimates are not classified as correcting errors.

10.13 If it is difficult to make a distinction between a change in an accounting policy and a revision to an accounting estimate, then the change is treated as that of an accounting estimate. [FRS102.10.15]

10.14 Changes in accounting estimates are recognised prospectively in profit or loss from the period of change. For example, a change in the estimate of the useful life or method of recognising depreciation for property, plant and equipment is accounted for prospectively as a change in estimate by adjusting depreciation in the current and future periods. Disclosure is made of the nature and effect of the change in accounting estimate. [FRS102.10.16]

Corrections of prior period errors

10.15 Prior period errors are omissions or misstatements in the financial statements relating to one or more prior periods arising from a failure to use (or misuse of) information that was available when the financial statements were authorised for issue, and that could reasonably have been expected to have been taken into account. Examples include mathematical mistakes, fraud and oversight of facts. [FRS102.10.19]

10.16 Omissions or misstatements are considered material if they could, individually or collectively, influence the economic decisions of the users of the financial statements. [FRS102.2.6]

10.17 Material prior period errors are corrected retrospectively in the first financial statements after their discovery by restating the comparative amounts, or (if the error occurred before the start of the earliest prior period presented) restating the opening balances of assets, liabilities and equity for the earliest prior period presented, unless it is impracticable to do so. [FRS102.10.21]

10.18 When it is impracticable to determine the period-specific effect of an error on comparative information, restatement is made for the earliest period for which retrospective restatement is practicable (which may be the current period). [FRS102.10.22]

10.19 The nature and extent of corrected material prior period errors are disclosed. [FRS102.10.23]
11

Basic financial instruments
Overview of requirements

- An entity can choose to follow either Section 11 Basic financial instruments and Section 12 Other financial instruments issues in full, or the recognition and measurement requirements of IAS 39/IFRS 9 plus the disclosure requirements of Sections 11 and 12 in accounting for all of its financial instruments.

- A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

- Section 11 covers basic financial instruments (e.g. cash, most fixed rate and variable rate loans, accounts receivable and payable, investments in non-convertible preference shares) and is relevant to all entities. Section 12 deals with more complex financial instruments. The recognition and measurement requirements of Sections 11 and 12 do not apply to those entities adopting IAS 39/IFRS 9.

- Most leases, share-based payments and other employee benefits, an entity’s own equity, financial guarantee contracts, other insurance contracts and investments in subsidiaries, associates and joint ventures are outside the scope of Section 11.

- Financial instruments within the scope of Section 11 are measured initially at the transaction price (sometimes including transaction costs) unless the arrangement is a financing transaction, in which case the instrument is recognised at the present value of the future payments discounted at a market rate of interest.

- Subsequent measurement of debt instruments within the scope of Section 11 is at amortised cost less impairment; commitments to receive or make a loan are measured at cost less impairment. The fair value option is available for certain debt instruments.

- Investments in non-convertible preference shares, non-puttable ordinary shares and non-puttable preference shares are measured subsequently at fair value through profit or loss or, if fair value cannot be measured reliably, at cost less impairment.

- Amortised cost is measured using the effective interest method applied to expected future cash flows over the life of the instrument.

- Impairment is assessed at each period end and any impairment loss is recognised in profit or loss.

- Fair value is estimated using a three-tier hierarchy (market price; recent transaction; valuation model).

- Financial assets are derecognised when the contractual rights to cash flows expire, are settled or are transferred and the transfer meets certain conditions.

- Accounting for non-cash collateral depends on the extent of the transfer.

- Financial liabilities are derecognised when the obligation is discharged, cancelled or expires, or when an exchange between an existing borrower and lender results in substantially different terms or a substantial modification.

- A financial asset and a financial liability are offset only when there is both a legally enforceable right to offset and an intention to settle net or to settle both amounts simultaneously.
vs previous UK GAAP – FRS 26 adopters
Applicable standards: FRS 26, FRS 29, UITF 42

pUK11.1 FRS 26 adopters should refer to the ‘vs EU-IFRS’ section as the requirements of FRS 26 are almost identical to those of IAS 39. FRS 26 is mandatory for entities listed on an EU-regulated market and those applying the fair value accounting rules of the Companies Act.

vs previous UK GAAP – non-FRS 26 adopters
Applicable standards: FRS 4, FRS 5, FRS 13, UITF 11

pUK11.2 No specific accounting standards for financial assets existed under previous UK GAAP. Financial assets are accounted for in the same way as other assets. Under the Companies Act’s historical cost accounting rules, fixed asset investments are recognised at cost less any provisions for permanent diminutions in value; current asset debtors and investments are recognised at the lower of cost and net realisable value. Any provisions for permanent diminutions in value are charged through the profit and loss account.

pUK11.3 Under the Companies Act alternative accounting rules a fixed asset investment may be held at market or directors’ valuation with movements through the statement of total recognised gains and losses; current asset investments may be held at their current cost. In practice it is more common for entities wishing to fair value to opt for fair value accounting through profit or loss and consequently apply FRS 26.

pUK11.4 Under the Companies Act, certain institutions such as banks and insurance companies are permitted to value trading book positions in transferable securities up to their net realisable value. This allows them, in effect, to fair value financial assets through profit or loss without applying the fair value accounting rules of the Act. This means they would not be required to adopt FRS 26.

pUK11.5 FRS 4 requires that debt is recognised initially at its net proceeds, being the fair value of the consideration received less issue costs. Unlike FRS 102, FRS 4 does not mandate initial recognition at fair value for loans financed at a below market rate.

pUK11.6 Derecognition under previous UK GAAP is based on the risks and rewards principles of FRS 5 rather than a combination of control and risks and rewards as under FRS 102.
Sections 11 and 12 broadly apply the classification and measurement requirements of IFRS 9, but the impairment and hedge requirements are based on IAS 39 because these phases are still under development by the IASB. The FRC intends to issue a supplementary exposure draft when the IASB finalises the IFRS 9 requirements for those areas. The paragraphs of this chapter most likely to change are paragraphs 11.16 to 11.19 dealing with impairment of financial instruments measured at cost or amortised cost and paragraphs 11.20 to 11.24 on amortised cost and the effective interest method.

**Scope and definitions**

11.1 Section 11 *Basic financial instruments* applies to all entities and covers recognition, derecognition, measurement and disclosure of ‘basic’ financial instruments. Section 12 *Other financial instruments issues* applies to entities entering into more complex financial instrument transactions. Section 22 *Liabilities and equity* deals with own equity and issued compound financial instruments.

11.2 An entity has an accounting policy choice to apply either:
- (a) Sections 11 and 12 in full;
- (b) the recognition and measurement provisions of IAS 39 (as adopted for use in the EU) and the disclosure requirements of Sections 11 and 12; or
- (c) the recognition and measurement provisions of IFRS 9 and IAS 39 (as amended following the publication of IFRS 9) and the disclosure requirements of Sections 11 and 12. [FRS102.11.2]

11.3 Public benefit entities and other members of a public benefit entity group refer to Section 34 *Specialised activities* for details of how to account for concessionary loans made or received. [FRS102.PBE11.1A] See Chapter 34K of this publication.

11.4 A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. [FRS102.11.3]

11.5 A financial asset is any asset that is:
- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
  - (i) to receive cash or another financial asset from another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity’s own equity instruments and:
  - (i) under which the entity is or may be obliged to receive a variable number of the entity’s own equity instruments; or
  - (ii) that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity’s own equity instruments. [FRS102.GL]

11.6 A financial liability is any liability that is:
- (a) a contractual obligation:
  - (i) to deliver cash or another financial asset to another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity’s own equity instruments and:
  - (i) under which the entity is or may be obliged to deliver a variable number of the entity’s own equity instruments;
IFRS 9 is not yet endorsed by the EU for use in Europe but is covered in this publication because it is available to FRS 102 users.

**Classification vs IAS 39**

IFRS11.1 IAS 39 has four different categories for financial assets: loans and receivables (measured at amortised cost); held-to-maturity (measured at amortised cost); available-for-sale (measured at fair value with fair value changes recorded in other comprehensive income) and fair value through profit or loss. IAS 39 has complex rules around the initial classification (including, in some cases, assessment of intentions) and the potential reclassification of financial assets.

IFRS11.2 Financial liabilities are measured at amortised cost unless they are derivatives or trading liabilities or the fair value option has been invoked.

IFRS11.3 IAS 39 includes the concept of an 'embedded derivative', which is a component of a ‘hybrid contract’ (i.e. a host contract containing an embedded derivative) that affects the cash flows of the hybrid contract in a manner similar to a stand-alone derivative. IAS 39 requires separate accounting for embedded derivatives with economic characteristics not closely related to the host contract, provided the hybrid contract is not accounted for at fair value through profit or loss in its entirety.

**Classification vs IFRS 9**

IFRS11.4 For financial assets, FRS 102 broadly applies the classification principles of IFRS 9. Under both standards financial assets are classified at initial recognition and subsequently measured either at amortised cost or at fair value. However, under IFRS 9 the amortised cost classification depends on both the entity’s business model for managing the financial assets and the contractual cash flow characteristics of the financial asset. Further, for investments in equity instruments that are not held for trading, the entity can make an election at initial recognition to present fair value changes in other comprehensive income.

IFRS11.5 As under IAS 39, financial liabilities are measured at amortised cost unless they are derivatives or trading liabilities or the fair value option has been invoked.

IFRS11.6 Embedded derivatives with host contracts that are not financial assets within the scope of IFRS 9 are assessed to determine whether the embedded derivative needs to be separated from the host contract. Embedded derivatives with host contracts that are financial assets within the scope of IFRS 9 are not separated.

**Measurement**

IFRS11.7 The IAS 39 and IFRS 9 requirements for the measurement of financial instruments (amortised cost and effective interest rate, fair value, impairment of financial assets) are broadly replicated in FRS 102. However, under IAS 39/IFRS 9 financial instruments are recognised initially at fair value which is usually identical to the FRS 102 requirement to measure at transaction price. Further, FRS 102 includes the practical expedient to measure short-term debt instruments that are not financing transactions at their undiscounted amounts payable or receivable.

IFRS11.8 IFRS 13, effective for annual periods beginning on or after 1 January 2013, provides a single source of guidance on how fair value is measured, and replaces fair value measurement guidance that was previously dispersed throughout IFRS (including IAS 39 and IFRS 9).
11 Basic financial instruments

or
(ii) will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity’s own equity instruments. [FRS102.GL]

11.7 Equity is the residual interest in the assets of the entity after deducting all its liabilities. [FRS102.GL]

11.8 Basic financial instruments in the scope of Section 11 are:
(a) cash;
(b) a debt instrument (e.g. demand and fixed-term deposits (e.g. bank accounts); bonds; accounts receivable and payable; loan notes receivable and payable) with all of the following characteristics:
(i) a fixed return amount, a fixed rate of return, or variable return equal to a single observable rate (e.g. LIBOR) or a combination of fixed and variable rates when both are positive (e.g. LIBOR plus 200 basis points);
(ii) no terms that could result in the lender losing the principal or attributable interest;
(iii) repayment terms are not contingent on future events or, if they are contingent on future events, they exist either to protect the lender from credit deterioration of the borrower or a change in control of the borrower, or to protect either party against changes in relevant taxation or law; and
(iv) no conditional returns or repayment provisions except those stated above;
(c) a commitment to receive or make a loan that cannot be settled net in cash and is expected to meet the criteria of (b) above;
(d) investments in non-convertible preference shares, non-puttable ordinary shares and non-puttable preference shares. [FRS102.11.8]

11.9 Financial instruments outside the scope of Section 11 are:
(a) investments in subsidiaries, associates and joint ventures – see Section 9 Consolidated and separate financial statements, Section 14 Investments in associates and Section 15 Investments in joint ventures, respectively;
(b) an entity’s own equity and the equity component of issued compound financial instruments – see Section 22;
(c) leases – see Section 20 Leases. However, the derecognition criteria in paragraphs FRS 102.11.33-35 and the impairment requirements in FRS 102.11.21-26 apply;
(d) contracts, rights and obligations of employers relating to employee benefits and share-based payments – see Section 28 Employee benefits and Section 26 Share-based payment;
(e) insurance contracts issued, reinsurance contracts issued or held and financial instruments issued with a discretionary participation feature – these will be within the scope of FRS 103 Insurance contracts (once issued).
See the Introduction to this publication;
(f) reimbursement rights – see Section 21 Provisions and contingencies;
(g) financial guarantee contracts – see Section 21. [FRS102.11.7]

11.10 When an entity follows the recognition and measurement provisions of either IAS 39 or IFRS 9 (see paragraph 11.2 of this publication), the scope of the relevant standard applies. [FRS102.11.2]

Recognition and measurement

11.11 Initial recognition of a financial asset or liability occurs when the entity becomes party to the contractual provisions of the instrument. [FRS102.11.12] The financial asset or liability is recognised initially at the transaction price (including transaction costs) except that for instruments subsequently measured at fair value through profit or loss, the amount recognised initially will exclude transaction costs. They will instead be charged immediately to profit or loss. However, if the arrangement is, in substance, a ‘financing transaction’, the instrument is measured initially at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. A financing transaction occurs when settlement is deferred beyond normal business terms or is financed at an interest rate that is not a market rate. [FRS102.11.13]

11.12 Debt instruments that otherwise meet the criteria for ‘amortised cost’ classification (see paragraph 11.14 of this publication) may, under certain circumstances, be designated as at fair value through profit or loss. The fair value option is available if the designation results in more relevant information, because either:
Derecognition

IFRS11.9 IAS 39 and IFRS 9 have identical requirements for the derecognition of financial assets and financial liabilities. FRS 102 establishes a simplified model for the derecognition of financial assets that does not involve the concepts of ‘pass-through’ or ‘continuing involvement’ that apply to derecognition of financial assets under IAS 39/IFRS 9. Further, IAS 39/IFRS 9 define ‘substantially different terms’ when considering whether a renegotiated financial liability is derecognised whereas FRS 102 does not.

Presentation

IFRS11.10 For both IAS 39 and IFRS 9 users the requirements for offset of financial assets and financial liabilities are included in IAS 32. The IAS 32 requirements are broadly consistent with FRS 102.

Disclosures

IFRS11.11 The IFRS 7 disclosure requirements for financial instruments apply to all entities using IFRS. The extent of disclosures required by FRS 102 is significantly less than those required by IFRS 7.
• it eliminates or significantly reduces an accounting mismatch that would otherwise result from measuring assets or debt instruments or recognising gains and losses on them on different bases; or
• a group of debt instruments (or financial assets and debt instruments) is managed and its performance evaluated on a fair value basis and information is provided to key management personnel on this basis. [FRS102.11.14(b)]

11.13 The designation of a debt instrument as at fair value through profit or loss may be used only on initial recognition and is not reversible.

11.14 Other debt instruments within the scope of Section 11 are measured at amortised cost using the effective interest method (see paragraphs 11.20 to 11.24 of this publication). For financial assets, the amortised cost amount includes, when necessary, a reduction for impairment or uncollectability. Short-term debt instruments (receivable or payable within one year) that are not financing transactions are measured at their undiscounted amounts receivable or payable. Financing transactions are measured using a market rate of interest for a similar debt instrument. A commitment to receive or make a loan within the scope of Section 11 is measured at cost less impairment.

11.15 Investments in non-convertible preference shares, non-puttable ordinary shares and non-puttable preference shares are measured at fair value through profit or loss when the fair value can be measured reliably, or else are measured at cost less impairment. [FRS102.11.14(d)]

11.16 When instruments are measured at cost less impairment or amortised cost less impairment, impairment is assessed at each period end when there is objective evidence of impairment. [FRS102.11.21] Objective evidence of impairment includes contract breach, significant financial difficulty or probable bankruptcy of the debtor. [FRS102.11.22]

11.17 Equity instruments carried at cost are assessed individually for impairment, regardless of significance. Other financial assets are assessed individually if significant, or else in groups with similar credit risk characteristics. [FRS102.11.24]

11.18 Impairment is measured as the difference between an asset’s carrying value and:
• for assets measured at amortised cost, the present value of estimated cash flows discounted at the asset’s original effective interest rate; or
• for assets measured at cost less impairment (i.e. commitments to receive or make a loan or investments in shares when the fair value cannot be measured reliably), the best estimate of the amount receivable on sale. [FRS102.11.25]

11.19 Impairment losses are recognised immediately in profit or loss. [FRS102.11.21] Any reversal of a previously recorded impairment loss in a subsequent period is also recognised in profit or loss. [FRS102.11.26]

**Amortised cost and effective interest method**

11.20 Amortised cost is the initial carrying amount less repayments, plus/minus cumulative amortisation (using the effective interest method), less any impairment. For short-term payables or receivables with no stated interest rate that are measured initially at their undiscounted amount, the adjustment for cumulative amortisation is not relevant since there is no difference between the amount at initial recognition and the maturity amount. [FRS102.11.15]

11.21 The effective interest rate is calculated at initial recognition of the debt instrument. It is the rate that discounts the expected future cash flows over the expected life of the instrument to the carrying amount of that instrument. For financing transactions (as described in paragraph 11.11 of this publication), the effective interest rate is the market rate of interest for a similar debt instrument. The interest expense or income for a period equals the brought forward carrying amount of the financial instrument multiplied by the effective interest rate for the period. [FRS102.11.16]

11.22 The calculation of amortised cost includes amortising any related fees, finance charges, transaction costs and other premiums or discounts over the expected life of the instrument, or the period to which these relate, if shorter. [FRS102.11.18] Cash flows include all contractual terms of the financial instrument but do not include possible future losses not yet incurred. [FRS102.11.17] For floating rate instruments recognised initially at an amount equal to the principal receivable or payable at maturity, interest income or expense is normally recognised based on the current market rate of interest. [FRS102.11.19]

11.23 Amortised cost is recalculated to reflect changes in expected cash flows (other than changes in a floating rate of interest) or the expected life of the instrument. The difference between the present value of future cash flows at the original effective interest rate, and the carrying amount, is recognised in profit or loss. [FRS102.11.20]

11.24 FRS 102.11.20 sets out a worked example of calculating amortised cost.

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**Fair value**

11.25 For those assets and liabilities, e.g. investments in shares, which are required to be measured at fair value, the fair value is estimated using the following three-tier hierarchy:

1. quoted (bid) price for an identical asset in an active market;
2. price of a recent transaction for an identical asset. If necessary, the price can be adjusted to reflect updated economic conditions or if evidence suggests that the recent transaction was not at fair value;
3. if there is no active market and no suitable recent transactions then a valuation technique is used to determine the arm’s length price for the asset. [FRS102.11.27] If a reliable, commonly-used valuation method exists in that market, then that technique is used. [FRS102.11.28]

11.26 For those investments in shares that fall into category (3) above, their fair value is measurable reliably if either (a) there is insignificant variability in the range of fair value estimates, or (b) a reasonable estimate of the fair value can be calculated by probability-weighting the possible outcomes. [FRS102.11.30]

11.27 If it is not possible to measure the fair value of investments in shares reliably, the entity measures the shares at cost less impairment. If an entity was able to measure the fair value of its investments in shares reliably but is no longer able to do so, then the carrying amount at the last date the asset was measurable reliably is taken as its cost. [FRS102.11.32]

**Derecognition**

11.28 A financial asset is derecognised when:

(a) the contractual rights to cash flows expire or are settled;
(b) substantially all the risks and rewards of ownership are transferred to another party; or
(c) some of the risks and rewards of ownership are transferred to another party and, in addition, control of the asset is transferred to that party such that the other party will be able to sell the whole asset externally without any restrictions. In this situation the entity derecognises the asset and any retained rights and obligations are recognised separately at fair value at the transfer date. Any difference between the amounts thus recognised and derecognised and the consideration received is recognised in profit or loss. [FRS102.11.33]

11.29 When some significant risks and rewards are retained by the entity and the entity retains control of the asset, this does not result in derecognition of the asset, but instead the recognition of a financial liability for the consideration received. These are not offset. [FRS102.11.34]

11.30 An example of a transfer that qualifies for derecognition is the following transfer of a number of trade receivables to a bank. The entity continues the credit control and must promptly send any monies received to the bank but it has no responsibility for slow or non-payment by the debtors. Therefore it has transferred substantially all the risks and rewards of the receivables and derecognises the asset. It recognises the difference between cash received from the bank and the carrying value of the receivables in profit or loss. The entity also recognises a liability for cash received from customers that it has not yet passed to the bank.

11.31 Varying the above example, if the entity had agreed to buy back any debtors overdue by more than 120 days, then it would not have transferred substantially all the risks and rewards and so would not derecognise the receivables. Instead, it would recognise the cash received from the bank as a secured loan. [FRS102.11.35]

11.32 A financial liability (or part of a financial liability) is derecognised when the obligation is discharged, cancelled or expires. [FRS102.11.36] The exchange between an existing lender and borrower of financial instruments with substantially different terms or a substantial modification of an existing debt instrument is treated as the extinguishment of the original financial liability and the recognition of a new financial liability. [FRS102.11.37] Any difference between the carrying amount of the original and new financial liability is recognised in profit or loss. [FRS102.11.38]

11.33 If a transfer involves non-cash collateral (e.g. debt or equity instruments) the accounting is as follows:

(a) If the transferee has no right to sell or repledge the collateral, the transferor continues to recognise it as an asset.
(b) If the transferee has the right to sell or repledge the collateral, the transferor classifies that asset separately from its other assets (e.g. loaned asset).
(c) If the transferee sells or repledges the collateral, it recognises the sale proceeds and a liability (measured at fair value) for the return of the collateral.
(d) If the transferor defaults on the contract and is no longer entitled to a return of the collateral, it derecognises the collateral. The transferee then recognises the collateral at fair value or derecognises its liability if it has already sold the collateral.

(e) Other than in (d), the transferee does not recognise the collateral as its asset and the collateral continues to be recognised as an asset of the transferor. [FRS102.11.35]

Presentation
11.34 Financial assets and financial liabilities are offset, and a net amount is presented in the balance sheet, if and only if both of the following conditions are met:

(a) the entity currently has a legally enforceable right to offset the recognised amounts; and

(b) the entity has the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. [FRS102.11.38A]

Disclosures
11.35 Section 11 includes a number of disclosure requirements in relation to financial instruments.

11.36 Qualifying entities applying FRS 102 (other than those which are financial institutions (as defined – see paragraph 1.32 of this publication)) that meet certain criteria are exempt from certain of these disclosure requirements. See paragraph 3.7 of this publication.

11.37 Additional disclosures are required to be given by financial institutions under Section 34 Specialised activities. See Chapter 34D of this publication.
Other financial instruments
Overview of requirements

• An entity can choose to follow either Section 11 Basic financial instruments and Section 12 Other financial instruments issues in full, or the recognition and measurement requirements of IAS 39/IFRS 9 plus the disclosure requirements of Sections 11 and 12 in accounting for all of its financial instruments.

• Section 12 covers other financial instruments that are not in the scope of Section 11.

• Most leases, share-based payments and other employee benefits, an entity’s own equity, financial guarantee contracts, other insurance contracts, business combinations and investments in subsidiaries, associates and joint ventures are outside the scope of Section 12.

• Initial measurement is at fair value.

• Subsequent measurement is at fair value through profit or loss except for those equity instruments for which fair value cannot be measured reliably; these are measured at cost less impairment.

• Guidance from Section 11 is applied for fair value, impairment and derecognition.

• An entity can qualify for hedge accounting if specific criteria are met. This allows the matching in profit or loss of the gains or losses on the hedged item and hedging instrument.

• A financial asset and a financial liability are offset only when there is both a legally enforceable right to offset and an intention to settle net or to settle both amounts simultaneously.
vs previous UK GAAP – FRS 26 adopters
Applicable standards: FRS 26, FRS 29, UITF 42, UITF 46

pUK12.1 FRS 26 adopters should refer to the ‘vs EU-IFRS’ section as the requirements of FRS 26 are almost identical to those of IAS 39. FRS 26 is mandatory for entities listed on an EU-regulated market and those applying the fair value accounting rules of the Companies Act.

vs previous UK GAAP – non-FRS 26 adopters
Applicable standards: SSAP 20, FRS 4, FRS 12, FRS 13, UITF 11

pUK12.2 The accounting for derivatives under previous UK GAAP depends on whether or not they are used for hedging. There is little formal guidance on hedge accounting for non-FRS 26 adopters. For example, there are no specific requirements for hedge documentation or hedge effectiveness but the derivative must eliminate or reduce risk from potential movements in interest rates, exchange rates and/or market price inherent in the assets, liabilities or cash flows being hedged. In practice, derivatives entered into for hedging purposes are typically accounted for on the same basis as the hedged asset, liability or cash flow. An example of such ‘synthetic accounting’ is that of a floating rate loan that is hedged with an interest rate swap, when the combination is accounted for as a ‘synthetic’ fixed rate loan. Further, SSAP 20 states specifically that contracted foreign exchange rates can be used to measure trading transactions in foreign currency (see also Section 30 Foreign currency translation).

pUK12.3 The accounting for derivatives that are not used for hedging is governed by the Companies Act and FRS 12. The initial payment for these derivatives is often nil, so, under historical cost accounting rules, there is nothing recognised on balance sheet unless the derivative meets the definition of an onerous contract under FRS 12 and a corresponding provision is recognised.

pUK12.4 Further, the Companies Act permits banks and insurance companies to value trading book derivatives that are transferable securities at net realisable value (even if the latter exceeds cost), allowing them in effect to fair value assets through profit or loss without applying the fair value accounting rules of the Act. This means they would not be required to adopt FRS 26.

pUK12.5 Net investment hedging under FRS 102 can be applied only on consolidation whereas under SSAP 20 the ‘cover concept’ may also be applied in individual accounts. Thus, under SSAP 20 when the company has used foreign currency borrowings to finance a foreign currency equity investment and hedge the exchange risk, the foreign exchange movements on both the foreign currency loan and the equity investment can be recognised through the statement of total recognised gains and losses, subject to certain conditions.

pUK12.6 The former British Banking Association Statement of Recommended Practice (BBA SORP) can be referred to for further guidance as to what was recommended practice for UK banks under previous UK GAAP.
Sections 11 and 12 broadly apply the classification and measurement requirements of IFRS 9, but the impairment and hedge requirements are based on IAS 39 because these phases are still under development by the IASB. The FRC intends to issue a supplementary exposure draft when the IASB finalises the IFRS 9 requirements for those areas. The paragraphs in this chapter most likely to change are paragraphs 12.12 to 12.14 on the criteria for hedge accounting and paragraphs 12.16 and 12.18 to 12.20 on some of the mechanics of hedge accounting.

Scope and definitions

12.1 Section 11 Basic financial instruments applies to all entities and covers recognition, derecognition, measurement and disclosure of ‘basic’ financial instruments. Section 12 Other financial instruments issues applies to entities entering into more complex financial instrument transactions. [FRS102.12.1] Section 22 Liabilities and equity deals with own equity and issued compound financial instruments. See Chapter 11 of this publication for the definitions of financial instruments, financial assets, financial liabilities and equity.

12.2 An entity has an accounting policy choice to apply either:
(a) Sections 11 and 12 in full;
(b) the recognition and measurement provisions of IAS 39 (as adopted for use in the EU) and the disclosure requirements of Sections 11 and 12; or
(c) the recognition and measurement provisions of IFRS 9 and IAS 39 (as amended following the publication of IFRS 9) and the disclosure requirements of Sections 11 and 12. [FRS102.11.2]

12.3 Public benefit entities and other members of a public benefit entity group refer to Section 34 Specialised activities for details of how to account for concessionary loans made or received. [FRS102.PBE12.1A] See Chapter 34K of this publication.

12.4 Section 12 applies to all financial instruments, except:
(a) those dealt with by Section 11;
(b) investments in subsidiaries, associates and joint ventures – see Section 9 Consolidated and separate financial statements, Section 14 Investments in associates and Section 15 Investments in joint ventures, respectively;
(c) contracts, rights and obligations of employers relating to share-based payments (unless they meet the description in paragraph 12.5 of this publication) and employee benefit plans – see Section 26 Share-based payment and Section 28 Employee benefits;
(d) insurance contracts issued, reinsurance contracts issued or held and financial instruments issued with a discretionary participation feature – see FRS 103 Insurance contracts (once issued). See the Introduction to this publication.
(e) an entity’s own equity and the equity component of issued compound financial instruments – see Section 22;
(f) leases – see Section 20 Leases – other than those leases that could result in a loss for either the lessor or the lessee due to contractual terms that are not typical of such contracts (see paragraph 20.5 of this publication);
(g) an acquirer’s contract for contingent consideration in a business combination, or a forward contract (covering only a reasonable period necessary to obtain relevant approvals and conclude the transaction) that will result in a future business combination – see Section 19 Business combinations and goodwill;
(h) reimbursement rights – see Section 21 Provisions and contingencies;
(i) financial guarantee contracts – see Section 21.
IFRS 9 is not yet endorsed by the EU for use in Europe but is covered in this publication because it is available to FRS 102 users.

**Hedge accounting**

IFRS12.1 FRS 102 restricts the scenarios when hedge accounting can be applied. For example, interest rate caps, floors and other options cannot be used as hedging instruments under FRS 102 but can be under IAS 39.

IFRS12.2 Conversely, the hedge documentation and effectiveness testing requirements are significantly more onerous under IAS 39. For example, IAS 39 requires an entity to carry out formal effectiveness testing throughout the hedge relationship. Hedge accounting is permitted only if changes in the fair value of the hedging instrument, and changes in the fair value of the hedged item attributable to the hedged risk, offset within the range of 80-125 percent. FRS 102 does not specify any thresholds for hedge effectiveness.

IFRS12.3 Further, the accounting on cessation of a hedge relationship is more complex under IAS 39. For example, on termination of a cash flow hedge, the subsequent accounting will depend on whether the previously hedged transaction is still expected to occur.

IFRS12.4 The hedge accounting requirements in IFRS 9 have not yet been issued by the IASB, but are likely to be less onerous than under IAS 39.

**Recognition and measurement**

IFRS12.5 See paragraphs IFRS11.1 to IFRS11.8 of this publication.

**Presentation**

IFRS12.6 See paragraph IFRS11.10 of this publication.

**Disclosures**

IFRS12.7 The IFRS 7 disclosure requirements for financial instruments apply to all entities using IFRS. The extent of disclosures required by FRS 102 is significantly less than those required by IFRS 7.
12.5 Contracts to buy or sell non-financial items are generally not in the scope of Section 12 unless:

- the contract includes risks that are not typical of such contracts (i.e. risks that are not changes in price, foreign exchange or default by one party); or
- the contract can be settled in cash, or with another financial instrument, and is not held for the entity’s own expected usage requirements. [FRS102.12.4,5]

12.6 Examples of financial instruments that are typically in the scope of Section 12 include derivatives and asset-backed securities (e.g. collateralised mortgage obligations).

12.7 When an entity follows the recognition and measurement provisions of either IAS 39 or IFRS 9 (see paragraph 12.2 of this publication), the scope of the relevant standard applies. [FRS102.12.2]

**Recognition and measurement**

12.8 Initial recognition of a financial asset or financial liability occurs when the entity becomes party to the contractual provisions of the instrument. [FRS102.12.6] On initial recognition, a financial asset or financial liability is measured at fair value plus directly attributable transaction costs, unless the instrument is classified as at fair value through profit or loss. Normally the fair value on initial recognition is the transaction price. However, for ‘financing transactions’, as defined in paragraph 11.11 of this publication, initial measurement discounts cash flows using a market rate of interest for a similar debt instrument. [FRS102.12.7]

12.9 Subsequent to initial recognition financial assets and financial liabilities are measured at fair value through profit or loss, except for equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably and hedging instruments in a designated hedge relationship. Equity instruments whose fair value cannot be measured reliably are measured at cost less impairment. [FRS102.12.8] If these instruments were previously measured at fair value but a reliable measure is no longer available then the carrying amount at the last date the asset was measurable reliably is taken as its ‘cost’. [FRS102.12.9] The subsequent measurement of hedging instruments is considered in paragraphs 12.16 and 12.17 of this publication.

12.10 The guidance in Section 11 is applied to financial instruments within the scope of Section 12 in relation to: the determination of fair value (see paragraphs 11.25 to 11.27 of this publication), impairment of assets recognised at cost less impairment (see paragraphs 11.16 to 11.19 of this publication), and derecognition (see paragraphs 11.28 to 11.33 of this publication).

12.11 When a financial liability is due on demand its fair value is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. [FRS102.12.11]

**Criteria for hedge accounting**

12.12 Hedge accounting can only be applied for the following types of risk:

- Interest rate risk and foreign exchange risk in a debt instrument measured at amortised cost.
- Foreign exchange and interest rate risk in a firm commitment or a highly probable forecast transaction. A highly probable forecast transaction is a future transaction that is significantly more likely than probable to occur but is not fully committed.
- Price risk of a commodity that the entity holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity.
- Foreign exchange risk in a net investment in a foreign operation. [FRS102.12.17]

12.13 Only certain types of financial instrument can be used as the hedging instrument. The hedging instrument is required to meet all of the following conditions:

- it is an interest rate swap, a foreign currency swap, a cross currency interest rate swap, a forward or future foreign currency exchange contract, a forward or future commodity exchange contract or, for a hedge of foreign exchange risk in a net investment in a foreign operation only, any financial instrument (e.g. foreign currency borrowings) that is expected to be highly effective in offsetting the designated hedged risk;
- it involves a party external to the reporting entity;
- its notional amount is equal to the designated principal or notional amount of the hedged item;
- its specified maturity date is not later than the maturity or expected settlement date of the hedged item; and
- it has no prepayment, early termination or extension features other than at fair value. [FRS102.12.18]
12.14 In addition, the following conditions are required to be met:
• the entity clearly documents the designated hedged risk, hedged item and hedging instrument; and
• the entity expects the hedge to be highly effective. Effectiveness is the extent to which the changes in fair value or cash flows of the hedged item that are attributable to the hedged risk are offset by changes in fair value or cash flows of the hedging instrument. [FRS102.12.16]

Hedge accounting models

12.15 FRS 102 has two different hedge accounting models that are explained in the following paragraphs.

12.16 The first hedge accounting model (consistent with fair value hedging) applies if the hedged risk is a fixed interest rate risk or foreign exchange risk of a financial instrument held at amortised cost, or a commodity price risk in a firm commitment or of a commodity held. A typical example is the hedging of the fixed interest rate risk (hedged risk) in a fixed rate loan (hedged item) with a fixed-for-floating interest rate swap (hedging instrument). The entity
(a) recognises the hedging instrument as an asset or liability with changes in its fair value recognised in profit or loss;
(b) recognises the changes in the fair value of the hedged item related to the hedged risk in profit or loss and as an adjustment to the carrying amount of the hedged item; [FRS102.12.19]
(c) when the hedging instrument is an interest rate swap, recognises in profit or loss on an accrual basis net cash settlements on the swap. [FRS102.12.20]

12.17 The second hedge accounting model (consistent with cash flow hedging or net investment hedging) applies if the hedged risk is a variable interest rate risk or foreign exchange risk of a debt instrument measured at amortised cost; a foreign exchange risk or interest rate risk in a firm commitment or highly probable forecast transaction; commodity price risk in a highly probable forecast transaction; or a foreign exchange risk in a net investment in a foreign operation. A typical example is the hedging of the foreign exchange risk (hedged risk) in a highly probable or committed purchase denominated in a foreign currency (hedged item) with a foreign currency forward contract (hedging instrument). The entity:
(a) recognises in other comprehensive income (OCI) the portion of the change in fair value of the hedging instrument that was effective in offsetting the change in the fair value or expected cash flows of the hedged item;
(b) recognises in profit or loss any excess (in absolute terms) of the cumulative change in fair value of the hedging instrument since inception of the hedge over the cumulative change in fair value of the expected cash flows of the hedged item since inception of the hedge (hedging ineffectiveness);
(c) reclassifies to profit or loss any hedging gain or loss previously recognised in OCI when the hedged item is recognised in profit or loss or when the hedging relationship ends, except for cumulative exchange differences recognised in OCI relating to a hedge of a net investment in a foreign operation on disposal or partial disposal of that foreign operation; [FRS102.12.23]
(d) when the hedging instrument is an interest rate swap, recognises in profit or loss on an accruals basis net cash settlements on the swap. [FRS102.12.24]

Discontinuation of hedge accounting

12.18 Hedge accounting is discontinued if:
(a) the hedging instrument expires or is sold or terminated (for example, an entity closes out an interest rate swap previously used for hedging interest rate risk);
(b) the hedge no longer meets the conditions for hedge accounting in FRS 102.12.16 (see paragraphs 12.12 to 12.14 of this publication) (for example, the hedge is no longer expected to be highly effective);
(c) in a hedge of a forecast transaction, the forecast transaction is no longer highly probable (for example, a previously forecast sale in foreign currency is no longer considered highly probable); or
(d) the entity revokes the designation. [FRS102.12.21,25]

12.19 For financial assets or liabilities at amortised cost that were hedged under the first hedge accounting model (as described in paragraph 12.16 of this publication), if hedge accounting is discontinued and the hedged financial asset or liability has not been derecognised, any gains or losses previously recognised as adjustments to the carrying amount of the hedged item are amortised into profit or loss using the effective interest method over the remaining life of the hedged item. [FRS102.12.22]
12.20 Under the second hedge accounting model (as described in paragraph 12.17 of this publication), any gain or loss on the hedging instrument that was recognised in OCI is reclassified from OCI to profit or loss when the hedge relationship ends, except for cumulative exchange differences recognised in OCI relating to a hedge of a net investment in a foreign operation on disposal or partial disposal of that foreign operation. [FRS102.12.23,25]

Presentation

12.21 Financial assets and financial liabilities are offset, and a net amount is presented in the balance sheet, if and only if both of the following conditions are met:
(a) the entity currently has a legally enforceable right to offset the recognised amounts; and
(b) the entity has the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. [FRS102.12.25A]

Disclosures

12.22 The disclosure requirements included within Section 11 apply equally to financial instruments within the scope of Section 12. Section 12 includes additional disclosure requirements for entities that use hedge accounting. [FRS102.12.26]

12.23 Qualifying entities applying FRS 102 (other than those that are financial institutions (as defined – see paragraph 1.32 of this publication)) that meet certain criteria are exempt from certain of these disclosure requirements. See paragraph 3.7 of this publication.

12.24 Additional disclosures are required to be given by financial institutions under Section 34 Specialised activities. See Chapter 34D of this publication.
Inventories
Overview of requirements

- This section applies to all inventories other than work in progress for construction contracts, financial instruments, biological assets relating to agricultural activity or produce at the point of harvest.

- This section does not apply to the measurement of inventories measured at fair value less costs to sell through profit or loss at each reporting date.

- Inventories are generally measured at the lower of cost and estimated selling price less costs to complete and sell.

- Cost includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

- When inventories are purchased on deferred settlement terms, any finance element of the cost is recognised as interest expense over the period of financing, unless the inventory is a qualifying asset and the entity has a policy of capitalising borrowing costs.

- When inventories are not interchangeable they are measured by identifying individual costs. For other inventories the first-in, first-out method or weighted average cost formula is used to measure cost. The last-in, first-out method is prohibited.

- Inventories are assessed for impairment at the end of each reporting date in line with Section 27 Impairment of assets.

- Inventories are recognised as an expense in the period in which the related revenue is recognised.
vs previous UK GAAP
Applicable standard: SSAP 9

pUK13.1 Whilst SSAP 9 refers to ‘net realisable value’ rather than ‘estimated selling price less costs to complete and sell’ this is a difference only in terminology. The definition of net realisable value sets out that it is the selling price less costs to complete and marketing, selling and distribution costs yet to be incurred.

pUK13.2 The use of LIFO is not prohibited but is extremely rare in practice.

pUK13.3 There are no special measurement rules for agricultural or mineral inventories.
Section 13

13.1 Inventories are assets:
(a) held for sale in the ordinary course of business;
(b) in the process of production for such sale; or
(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. [FRS102.13.1]

13.2 This section applies to all inventories, except:
(a) work in progress arising under construction contracts, including directly related service contracts – see Section 23 Revenue;
(b) financial instruments – see Section 11 Basic financial instruments and Section 12 Other financial instruments issues;
(c) biological assets related to agricultural activity and agricultural produce at the point of harvest – see Section 34 Specialised activities. [FRS102.13.2]

13.3 This section does not apply to the measurement of inventories that are measured at fair value less costs to sell through profit or loss at each reporting date. [FRS102.13.3]

Measurement of inventories

13.4 Inventories are measured at the lower of cost and estimated selling price less costs to complete and sell. [FRS102.13.4]
When inventories are held for distribution (for example, items to be distributed to beneficiaries by public benefit entities and promotional materials) they are measured at cost less loss of service potential. [FRS102.13.4A, FRS102.A4.36,37]

13.5 The cost of inventories includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. [FRS102.13.5] If acquired through a non-exchange transaction, inventories are measured at acquisition date fair value. For public benefit entities and entities within a public benefit entity group, this applies only when incoming resources are recognised (see Section 34).

13.6 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase. [FRS102.13.6]

13.7 When inventories are purchased on deferred settlement terms, any finance element is recognised as interest expense over the period of financing. It is not part of the cost of the inventories unless the inventory is a qualifying asset (see Section 25 Borrowing costs) and the entity adopts a policy of capitalisation of borrowing costs. [FRS102.13.7]

13.8 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour. [FRS102.13.8]

13.9 Other costs are included only to the extent they are incurred in bringing the inventories to their present location and condition. [FRS102.13.11]

13.10 An entity may hedge the fixed interest rate risk of a financial instrument held at amortised cost or the commodity price risk in a firm commitment or of a commodity held. As further explained in paragraph 12.16(b) of this publication, in certain circumstances the change in the fair value of the hedging instrument will adjust the carrying amount of the related inventories. [FRS102.13.12]
### vs EU-IFRS

**Applicable standard: IAS 2**

**IFRS13.1** IAS 2 refers to ‘net realisable value’ rather than ‘estimated selling price less costs to complete and sell’. However, the way that net realisable value is defined in IAS 2.6 means this is not a measurement difference in practice.

**IFRS13.2** IAS 38.69 (c) requires that expenditure on advertising and promotional activities (including mail order catalogues) are expensed when the benefit of those goods or services is available to the entity.

**IFRS13.3** The inclusion of borrowing costs in the cost of inventories is required in certain circumstances.
13.11 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred include:

(a) abnormal amounts of wasted materials, labour or other production costs;
(b) storage costs, unless those costs are necessary during the production process before a further production stage;
(c) administrative overheads that do not contribute to bringing inventories to their present location and condition;
(d) selling costs. [FRS102.13.13]

13.12 In some cases, the cost of inventories may be approximated using techniques such as:

(a) standard cost – using normal levels of material, supply, labour, efficiency and capacity. The ‘normal’ base is reviewed regularly to reflect current conditions;
(b) retail method – using percentage gross margin to reduce sales value; and
(c) most recent purchase price. [FRS102.13.16]

13.13 The cost of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects is measured by using specific identification of their individual costs. [FRS102.13.17]

13.14 The first-in, first-out (FIFO) or weighted average cost formula is used to measure the cost of inventories, other than those detailed in paragraph 13.13 of this publication. The same cost formula is used for all inventories which are similar in nature or use. For inventories with a different nature or use, different cost formulas may be justified. The last-in, first-out method (LIFO) is not permitted. [FRS102.13.18]

Impairment

13.15 Inventories are assessed for impairment at the end of each reporting date, as described in Section 27 Impairment of assets. An impairment is recognised when the carrying amount is not fully recoverable, for example due to damage, obsolescence or declining selling prices. When an item (or group of items) is impaired, it is measured at its selling price less costs to complete and sell and an impairment loss is recognised. A reversal of a prior impairment is required in some circumstances. [FRS102.13.19]

Recognition as an expense

13.16 The carrying amount of inventory is recognised as an expense in the period in which the related revenue is recognised or when inventory held for distribution is distributed. [FRS102.13.20,20A]

13.17 Inventory allocated to another asset (e.g. used to construct property, plant or equipment) is then accounted for under the appropriate section of FRS 102 (e.g. Section 17 Property, plant and equipment). [FRS102.13.21]

Service providers

13.18 Service providers measure their inventory at cost of production, including costs of labour and attributable overheads.

13.19 Sales and general administrative costs are recognised as expenses in the period incurred.

13.20 Profit margins and non-attributable overheads are not included in the cost of inventories although they are often included in the price to customers. [FRS102.13.14]

Agricultural produce

13.21 See Section 34 for guidance on agricultural produce harvested from biological assets. These are measured initially, at the point of harvest, either at fair value less costs to sell or the lower of cost and estimated selling price less costs to sell. This becomes the cost of the inventories at that date for the application of this section. [FRS102.13.15]
Overview of requirements

- An associate is an entity over which an investor has significant influence but that is not a subsidiary or a joint venture.

- In consolidated financial statements, associates are accounted for using the equity method unless they are part of an investment portfolio.

- In individual financial statements, a policy choice is available to account for interests in associates either at cost less impairment, at fair value with movements above cost recognised through other comprehensive income or at fair value with changes in fair value recognised in profit or loss.
Associates

pUK14.1 For an associate relationship to exist, the definition of an associate in FRS 9 requires that an investor holds a participating interest and actually exercises significant influence over an investee.

pUK14.2 Under FRS 9, in individual financial statements, investments in associates are shown either at cost less impairment, or at a valuation. Movements in the valuation are recognised in reserves unless they are downward revaluations below depreciated historical cost (but above recoverable amount) or represent a clear consumption of economic benefit. In such cases they are recognised in profit or loss; fair value through profit or loss is not an available policy choice.

pUK14.3 Under previous UK GAAP, to the extent that a dividend from an investment reduces its value below its carrying amount, it is a return of investment rather than income. That portion of the dividend is therefore credited directly against the carrying amount of the investment rather than being recorded in the profit and loss account together with an impairment.

Equity accounting

pUK14.4 Under both FRS 9 and FRS 102, an investor adjusts its share of the profits and losses of an associate for the effects of implicit goodwill and fair value adjustments (for example, by recognising additional amortisation and depreciation). Differences may arise because of the different requirements for acquisition accounting (see Chapter 19 of this publication) and because of different requirements for amortisation and depreciation. For example, goodwill arising on the acquisition of an investment in an associate is typically amortised over no more than 20 years under FRS 10; FRS 102 introduces a presumption that its life does not exceed five years unless a reliable estimate of its life can be made.

pUK14.5 The equity accounting model in FRS 102 recognises a ‘share of profit’ on a post-tax basis. Under FRS 9 ‘share of result’ is included on an operating profit basis, with the investor’s share of interest and tax disclosed adjacent to (interest) or as part of (tax) the respective lines of the consolidation.

pUK14.6 Under FRS 102, a share of net liabilities/losses of an associate is recognised only if it meets the definition of a provision. Under FRS 9, the share of net liabilities is recognised unless there is sufficient evidence that the relationship between the investor and its investee has changed irrevocably, marking the investor’s irreversible withdrawal from the investee as its associate, for example, by making a public statement of withdrawal. It is therefore less likely that a provision will be recognised for net liabilities of associates under FRS 102.

Investment funds

pUK14.7 Under FRS 9, investment funds, such as those in the venture capital and investment trust industry, have the choice of measuring all investments in their investment portfolio (including those over which they have significant influence) either at cost or market value, as long as they are all measured on the same basis. Under FRS 102, associates held as part of an investment portfolio are measured at fair value through profit or loss.
14 Associates

14.1 An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture. [FRS102.14.2]

14.2 Significant influence is the power to participate in the financial and operating policy decisions of the associate but is not control or joint control over those policies. [FRS102.14.3]

14.3 Significant influence is presumed to exist when the investor holds, directly or indirectly, 20 percent or more of the voting power of the associate. Conversely, if less than 20 percent is held, it is presumed that the investor does not have significant influence. Each of these presumptions is overturned if it can be clearly demonstrated not to be the case. Examples of ways that significant influence might be evidenced include representation on the board, participation in policy making, or the right of veto for certain transactions or policies. The fact that another investor holds a substantial or majority interest does not preclude an investor from having significant influence. [FRS102.14.3]

Measurement

14.4 In its consolidated financial statements, an investor accounts for its investments in associates using the equity method unless they are part of an investment portfolio (see paragraph 14.9 of this publication). [FRS102.14.4A]

Individual financial statements

14.5 In its individual financial statements (see paragraph 9.41 of this publication) an investor has an accounting policy choice (applying paragraphs FRS 102.9.26 and FRS 102.9.26A) between measuring investments in associates at:
   • cost less impairment (assessed in accordance with Section 27 Impairment of assets [FRS102.14.5]); or
   • fair value with movements recognised in other comprehensive income while the fair value of the investment remains above cost, and profit or loss if fair value is less than cost (see paragraph 17.18 of this publication); or
   • fair value through profit or loss. [FRS102.14.4]

14.6 This choice is available whether or not the investor is also a parent, i.e. also has subsidiaries. For guidance on fair value see paragraph 11.25 of this publication. [FRS102.14.1,4]

14.7 Dividends and other distributions received from associates are recognised as income. This applies whether they are paid from pre- or post-acquisition accumulated profits of the associate. [FRS102.14.6,10A]

14.8 An investor that is measuring an associate at fair value remeasures its investment to fair value at each reporting date. The cost model is used by an investor otherwise applying the fair value model when it is impracticable to measure fair value reliably without undue cost or effort. [FRS102.14.10]

Associates held as part of an investment portfolio

14.9 In consolidated financial statements, associates held as part of an investment portfolio are measured at fair value with changes in fair value recognised in profit or loss, rather than being accounted for using the equity method. An associate is held as part of an investment portfolio if it is part of a basket of investments that is held (directly or indirectly) to benefit from changes in its fair value, rather than as a vehicle through which the investor carries out business activities. When an investment fund holds an investment in another fund which itself holds a basket of investments, that basket of investments is said to be held indirectly. [FRS102.14.4B]
IFRS14.1 Under both EU-IFRS and FRS 102, an investor adjusts its share of the profits and losses of an associate for the effects of implicit goodwill and fair value adjustments (for example, by recognising additional amortisation and depreciation). Differences between EU-IFRS and FRS 102 may arise because of the different requirements for acquisition accounting (see Chapter 19 of this publication) and because of different requirements for amortisation and depreciation. For example, goodwill arising on the acquisition of an investment in an associate is not amortised under EU-IFRS.

IFRS14.2 Under EU-IFRS, when significant influence is lost the remaining investment is remeasured to fair value. FRS 102 requires that, if significant influence is lost for reasons other than a partial disposal, and any retained interest is neither a subsidiary nor a joint venture, then the investor regards the carrying amount of the investment at the date that significant influence was lost as its cost. However, this apparent difference may not be as significant as it first appears. That is because FRS 102 will, in many cases, require the retained interest to be recorded as a financial instrument at fair value through profit or loss.

IFRS14.3 Under EU-IFRS, when an associate becomes a joint venture or a subsidiary, the investment is remeasured to fair value through profit or loss.

IFRS14.4 Under EU-IFRS, an optional exemption from equity accounting exists for investments in associates held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that, upon initial recognition, are designated as at fair value through profit or loss. The equivalent exemption in FRS 102 applies to associates held as part of an investment portfolio and is mandatory.

1 For entities applying IFRS 11, when an investor moves from having significant influence to having joint control, there is no remeasurement of the retained investment.
**Equity method**

14.10 Under the equity method of accounting, the investment is recognised initially at the transaction price (including transaction costs). [FRS102.14.8] It is subsequently adjusted to reflect:

(a) The **investor’s share of the profit or loss, other comprehensive income and equity** of the associate. Note that the share of profit or loss is the share of the post-tax result of the associate from the bottom line of its income statement. Unless impractical to do so, this is taken from financial statements of the associate prepared to the same date as those of the investor and adjusted to reflect the investor’s accounting policies. Otherwise, the most recent financial statements of the associate are used, adjusted for significant transactions between its period end and that of the investor. The investor’s share of profit or loss and other comprehensive income and share of changes in equity are measured on the basis of present ownership interest; the possible exercise or conversion of potential voting rights is not taken into account.

(b) **Distributions received reduce the carrying amount of the investment.**

(c) **Implicit goodwill and fair value adjustments.** On acquisition, any difference (positive or negative) between the cost of acquisition and the investor’s share of the fair values of the net identifiable assets of the associate is accounted for as goodwill or negative goodwill in accordance with Section 19 *Business combinations and goodwill*. [FRS102.19.22-24] The investor’s share of the associate’s profits or losses recognised after acquisition is adjusted to take account of any additional amortisation of goodwill or depreciation and amortisation of fair value adjustments.

(d) **Impairment.** When an indicator of impairment exists the entire carrying amount of the investment (including any related goodwill) is tested for impairment as a single asset in accordance with Section 27.

(e) **Investor’s transactions with associates.** Profits or losses resulting from upstream (associate to investor) and downstream (investor to associate) transactions are eliminated to the extent of the investor’s interest in the associate. Losses on such transactions may provide evidence of an impairment of the asset transferred.

(f) **Recognition of losses in the associate.** When the investor’s share of losses of an associate equals or exceeds the carrying amount of its investment, the investor stops recognising its share of further losses. Once the investment is reduced to zero, the investor recognises additional losses as a provision in accordance with Section 21 *Provisions and contingencies only* to the extent that the investor has incurred legal or constructive obligations or has made payments on behalf of the associate. The investor recognises its share of any subsequent profits only after its share of profits equals its share of losses not recognised.

14.11 An entity may contribute a business or other non-monetary asset in return for an interest in an associate. To the extent that it retains an interest in the business or asset contributed, that interest is treated as if it has continued to be owned by the entity throughout the transaction and is included at its pre-transaction carrying amount. The consideration given for the interest acquired includes the fair value of the part of the business or non-monetary asset contributed that is no longer held. Goodwill is computed on the acquired interest as the difference between the fair value of the consideration given and the fair value of the entity’s share of the net assets of the other entity that have been acquired. Paragraph 15.19 of this publication illustrates how goodwill is computed in this situation. [FRS102.9.31]

**Discontinuing the equity method**

14.12 An investor stops using the equity method from the date that it ceases to have significant influence over its former associate. [FRS102.14.8(i)]

14.13 If an associate becomes a subsidiary, the investor derecognises its equity accounted investment on the date that it gains control and applies Section 19, save for the calculation of goodwill. Goodwill is recorded on the date that control is gained by adding together the goodwill arising on each tranche purchased. It is calculated as the difference between the cost of that tranche and the fair value (at the date of original purchase) of the identifiable assets and liabilities attributable to the tranche. In other words, the goodwill underlying the existing associate stake is not revalued (in a separate step the identifiable net assets are, however, revalued). Legal Appendix 4.17 to FRS 102 explains that this is an instance of the true and fair override (see paragraph 3.55 of this publication).

14.14 If significant influence is lost as a result of the investor’s disposing of some or all of its investment (‘a full or partial disposal’), a profit or loss will arise. This is comprised of two items: first, the difference between the proceeds received and the proportionate share of the carrying amount of the investment that is disposed of; and, second, any amounts previously recognised in other comprehensive income in relation to the associate that are required by other sections of the standard to be recycled to profit or loss on a disposal. Amounts recognised in other comprehensive income in relation to the associate that are not required to be so recycled are instead transferred within equity directly to retained earnings, if they were recognised originally in a different component of equity.
14.15 The proportion of the carrying value retained is treated as the cost of any interest retained. Subsequently, any retained interest is accounted for using Section 11 *Basic financial instruments* or Section 12 *Other financial instruments issues* as appropriate. Section 12 will, in many cases, require the retained interest to be carried at fair value with movements recorded in the profit and loss account. Similarly, Section 11 may require certain retained interests to be measured at fair value. To the extent that there is a difference between the fair value of the retained interest and the proportionate share of the book value retained, an immediate gain or loss will arise.

14.16 If an investor loses significant influence for other reasons (i.e. other than having disposed of some or all of its investment) the carrying amount of the investment at that date is regarded as the cost of the retained interest which is accounted for using Section 11 or 12, as appropriate. Similar to paragraph 14.15 of this publication, the application of Section 11 or 12 may result in an immediate gain.
Joint ventures
Overview of requirements

• A joint venture is a contractual arrangement between two or more parties to carry out an economic activity under joint control.

• If a joint venture is carried out through an entity, it is treated as a Jointly Controlled Entity (JCE).

• In consolidated financial statements JCEs are accounted for using the equity method.

• In individual financial statements, a policy choice is available to account for interests in JCEs either at cost less impairment, at fair value with movements above cost recognised through other comprehensive income or at fair value with changes in fair value recognised in profit or loss.

• If a joint venture is not carried out through a separate entity, then it is treated as either a Jointly Controlled Asset (JCA) or a Jointly Controlled Operation (JCO).

• In respect of JCAs and JCOs, a venturer records in its own (i.e. individual financial statements) balance sheet the assets that it controls and the liabilities that it incurs along with its share of any jointly controlled assets or jointly incurred liabilities. In its own profit and loss account, a venturer records its income from selling its share of the joint venture’s output; the expenses that it has incurred in respect of the joint venture; and its share of any income earned or expenses incurred by the joint venture.
Joint ventures

pUK15.1 FRS 9 defines a joint venture as an entity held on a long-term basis and subject to joint control. It is an entity in substance as well as in form, which requires it to be a stand-alone business with, for example, policy set in its own right rather than its activities being predetermined. An incorporated undertaking is not necessarily an entity when applying FRS 9.

pUK15.2 When a joint arrangement is not an entity, each party includes in its individual (and hence also in its consolidated) financial statements its share of assets, liabilities and cash flows, measured according to the terms of the arrangement.

pUK15.3 FRS 9 requires that, in consolidated financial statements, an investor includes its joint ventures using the gross equity method. Under the gross equity method, the net of the amounts reflected in the investor’s financial statements is the same as that reported using the FRS 102 equity method. However, there is expanded disclosure. In particular, under the gross equity method in FRS 9:

- the investor’s share of the gross assets and liabilities of equity accounted investees is noted on the face of the balance sheet;
- the investor’s share of the investee’s turnover is noted on the face of the profit and loss account; and
- the ‘share of result’ included in the profit and loss account is a share of the joint venture’s operating profit with the share of its tax and interest shown separately. In FRS 102, the ‘share of result’ is a share of profit after tax.

pUK15.4 Under FRS 9, in the investor’s individual financial statements, investments in joint ventures are treated as fixed asset investments and shown typically at cost less impairment. Alternatively, they may be held at fair value, with movements above cost recognised through the statement of total recognised gains and losses; fair value through profit or loss is not an available policy choice.

pUK15.5 Under FRS 9, in individual accounts, dividends received are not always recorded in the profit and loss account. Instead, to the extent that they result in a decrease in the value of the investee below its carrying value, they are treated as a return of capital and set against the carrying value of the investment using the direct credit method.

Equity accounting

pUK15.6 As discussed in Chapter 14 of this publication, there are a number of differences between the mechanics of equity accounting in FRS 9 and FRS 102.

Investment funds

pUK15.7 Under FRS 9, investment funds, such as those in the venture capital and investment trust industries, measure all investments in their investment portfolio in the same way (at cost or market value), even those over which the investor has joint control. Under FRS 102, JCEs held as part of an investment portfolio are measured at fair value through profit or loss.
**Joint ventures**

15.1 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of JCOs, JCAs, or JCEs. [FRS102.15.3]

15.2 Joint control is the contractually-agreed sharing of control (see paragraphs 9.13 to 9.17 of this publication) over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers). [FRS102.15.2]

**Jointly controlled operations (JCOs)**

15.3 JCOs involve the use of assets and resources of the venturers rather than the establishment of a separate entity or financial structure separate from the venturers themselves. Each venturer uses its own assets and incurs its own expenses and liabilities and raises its own finance. The JCO’s activities may be carried out by the venturer’s employees alongside its other business activities. The joint venture agreement will normally include a means by which revenue from the joint venture and any common expenses incurred are shared among the venturers. [FRS102.15.4]

15.4 JCOs are accounted for in the venturer’s individual financial statements (and hence in its consolidated financial statements) by the venturer recognising:

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture. [FRS102.15.5]

**Jointly controlled assets (JCAs)**

15.5 JCAs involve the joint control, and/or joint ownership, of one or more assets acquired for the joint venture and dedicated to the purposes of the joint venture. [FRS102.15.6]

15.6 JCAs are accounted for by the venturer recognising in its individual (and consolidated) financial statements:

(a) its share of each of the jointly controlled assets;

(b) any liabilities that it has incurred;

(c) its share of each of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses that it has incurred in respect of its interest in the joint venture. [FRS102.15.7]

**Jointly controlled entities (JCEs)**

15.7 A JCE is a joint venture that involves the establishment of a company, partnership or other entity in which each venturer has an interest. [FRS102.15.8]

**Measurement – individual financial statements**

15.8 In its individual financial statements, FRS 102.9.25-26 give a venturer an accounting policy choice between measuring interests in JCEs at cost less any accumulated impairment losses recognised in accordance with Section 27 Impairment of assets, at fair value under the fair value model (see next paragraph) or at fair value through profit or loss (see paragraph 11.25 of this publication for guidance on fair value). [FRS102.15.1,9] This choice is available whether or not the investor is also a parent, i.e. also has subsidiaries.
IFRS15.1 In its consolidated financial statements, IAS 31 requires a venturer to account for an interest in a JCE using either proportionate consolidation or the equity method.

IFRS15.2 In its individual financial statements, an investor has an accounting policy choice to account for investments in JCEs either at cost or by applying IAS 39.

IFRS15.3 Under EU-IFRS, an optional exemption from equity accounting exists for investments in JCEs held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that, upon initial recognition, are designated as at fair value through profit or loss. The equivalent exemption in FRS 102 applies to JCEs held as part of an investment portfolio and is mandatory.

Forthcoming requirements

IFRS15.4 IFRS 11 replaces IAS 31 for entities applying ‘full IFRS’ for accounting periods beginning on or after 1 January 2013. Under EU-IFRS, the effective date is 1 January 2014. Under IFRS 11, the option in IAS 31 to use proportionate consolidation is removed. In addition, IFRS 11 requires certain joint arrangements that are structured through an entity to be treated as joint operations (i.e. in a similar way to JCOs and JCAs) when they are set up in a way that gives the venturers rights to their assets, and obligations for their liabilities.
**Fair value model**

15.9 Under the fair value model, at each reporting date the JCE is remeasured to fair value. Changes in fair value are recognised in accordance with paragraph 17.18 of this publication, i.e. through other comprehensive income so long as the fair value is above cost and through profit or loss when fair value is below cost. The cost model is used by an investor otherwise applying the fair value model when it is impracticable to measure fair value reliably without undue cost or effort. [FRS102.15.15]

15.10 Dividends and other distributions received from the JCE are recognised as income, regardless of whether distributions paid are from pre- or post-acquisition accumulated profits of the JCE. [FRS102.15.11,15A]

**Measurement – consolidated financial statements**

15.11 In its consolidated financial statements, a venturer accounts for its investments in JCEs using the equity method, unless they are part of an investment portfolio (see below). [FRS102.15.9A]

15.12 In consolidated financial statements, JCEs held as part of an investment portfolio are measured at fair value with changes in fair value recognised in profit or loss, rather than being accounted for using the equity method. [FRS102.15.9B] A JCE is held as part of an investment portfolio if it is part of a basket of investments that is held (directly or indirectly) to benefit from changes in its fair value rather than as a vehicle through which the investor carries out business activities. When an investment fund holds an investment in another fund, which itself holds a basket of investments, that basket of investments is said to be held indirectly.

15.13 An investor in a joint venture that does not have joint control accounts for that investment in accordance with Section 11 Basic financial instruments or Section 12 Other financial instruments issues or, if it has significant influence in the joint venture, in accordance with Section 14 Investments in associates. [FRS102.15.18]

**Equity method**

15.14 The accounting for a JCE using the equity method is the same as that for an associate, as set out in paragraph 14.10 of this publication. [FRS102.15.13]

**Loss of joint control**

15.15 An investor accounts for the loss of joint control over a JCE as for the loss of significant influence over an associate, as set out in paragraphs 14.12 to 14.16 of this publication, substituting ‘joint control’ for ‘significant influence’. [FRS102.15.13]

**Transactions between a venturer and a joint venture**

15.16 When a venturer contributes or sells assets to a joint venture, it recognises only the portion of the gain or loss attributable to the interests of the other venturers. However, if the sale or contribution provides evidence of an impairment loss then that loss is recognised by the venturer. [FRS102.15.16]

15.17 When a venturer purchases assets from a joint venture, the venturer does not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. FRS 102 does not specify what it means by ‘independent party’. [FRS102.15.17]

15.18 An entity may contribute a business or other non-monetary asset in return for an interest in a joint venture. To the extent that it retains an interest in the business or asset contributed, that interest is treated as if it has continued to be owned by the entity throughout the transaction and is included at its pre-transaction carrying amount. The consideration given for the interest acquired includes the fair value of the part of the business or non-monetary asset contributed that is no longer held. Goodwill is computed on the acquired interest as the difference between the fair value of the consideration given and the fair value of the entity’s share of the net assets of the other entity that have been acquired. [FRS102.9.31]

15.19 For example, entities X and Y contribute their subsidiaries X1 and Y1 to a newly-formed JCE. In return, they each obtain a 50 percent stake in the JCE. Before the transaction, the book value of X1’s net assets in X’s consolidated accounts are 100. The fair value of X1 is 150. Entity X continues to carry the 50 percent interest in X1 that it retains at its pre-transaction carrying amount of 50 (i.e. 50% x 100). In addition, it obtains 50 percent of Y1 for consideration of 50 percent of the fair value of X1, being 75 (50% x 150). It therefore records that 50 percent at 75 and computes goodwill based on the difference between 75 and the fair value of Y1’s identifiable net assets. X’s investment in the new JCE is therefore recorded at a total of 125 (50 + 75) and it records a gain of 25 on the disposal of 50 percent of X1 (50% x (fair value of 125 – book value of 100)).
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Investment property
Overview of requirements

- Investment property is land or buildings held to earn rentals, for capital appreciation, or both.
- Investment property is measured initially at cost. Cost includes any directly attributable expenses.
- In subsequent accounting periods, it is revalued to fair value through profit or loss, unless fair value cannot be measured reliably without undue cost or effort on an ongoing basis. In such cases, the investment property is accounted for as property, plant and equipment under Section 17 Property, plant and equipment.
Cutting through UK GAAP

There are differences in the definition of an investment property. Under SSAP 19:

- any rental income is negotiated on an arm’s length basis;
- construction and development work is completed before a property is classified as an investment property;
- a property leased within a group is not an investment property in either the individual entity or group accounts;
- there is no concept of not being able to measure an investment property reliably.

Under SSAP 19, investment property is carried at open market value. Changes in value, other than permanent diminutions, are charged or credited through the statement of total recognised gains and losses (STRGL) to an investment revaluation reserve within shareholders’ funds. Permanent diminutions are charged through the profit and loss account. Insurance companies take investment property revaluations through the profit and loss account.

Fair value is defined in FRS 102 as ‘the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm’s length transaction.’ The term ‘open market value’ for the valuation of investment properties is not defined in SSAP 19 but is defined in FRS 15 as having ‘the same meaning as in the Appraisal and Valuation Manual published by the RICS’, and is reproduced in Appendix 1 to FRS 15. Only an open market value without further qualification of any sort complies with the valuation requirements of SSAP 19. In practice, fair value and open market value seem likely to be the same for investment property.

Similarly to FRS 102, freehold investment properties generally are not depreciated under SSAP 19. However, under SSAP 19 investment properties held on leases may be depreciated and are required to be depreciated if the unexpired term of the lease is 20 years or less.

Neither FRS 102 nor SSAP 19 requires valuations to be carried out by qualified or independent valuers. However, when a major entity holds significant levels of investment property, SSAP 19 suggests that the properties would normally be revalued annually by persons holding a recognised professional qualification and at least every five years by an external valuer.

IAS 40 requires an entity to choose either the fair value model or the cost model. The chosen policy applies to all of an entity’s investment property. There is a limited exemption from fair value accounting, which is available only on initial recognition on a property-by-property basis when fair values cannot be established reliably on an ongoing basis.

IAS 40 requires an entity that has chosen the cost model to disclose the fair value of investment property, with limited exceptions that apply only if fair value was not readily determinable on initial recognition.

Under IAS 40, there is more detailed guidance regarding dual-use properties. A portion of a dual-use property is either capable of separate disposal, or leased out separately under a finance lease to be classified as an investment property.

There is an explicit test in IAS 40 as to whether a property can be an investment property if the lessor provides some ancillary services.
Definition and recognition

16.1 Investment property is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for:
   (a) use in the production or supply of goods or services or for administrative purposes; or
   (b) sale in the ordinary course of business. [FRS102.16.2]

16.2 There is a classification option, available on a property-by-property basis, for property interests held by a lessee under an operating lease to be accounted for as investment property. This can be applied when the property would otherwise meet the definition of an investment property, i.e. the leased property is held for capital appreciation or rental income and the lessee can measure the fair value of the property interest without undue cost or effort on an ongoing basis. [FRS102.16.3]

16.3 When a property’s primary purpose is the provision of social benefits e.g. social housing, it is not classed as investment property and is accounted for under Section 17 Property, plant and equipment. [FRS102.16.3A]

16.4 When a property has a mixed use its classification is split between investment property and property, plant and equipment. However, if the fair value of the investment property component cannot be measured reliably without undue cost or effort, the entire property is accounted for as property, plant and equipment in accordance with Section 17. [FRS102.16.4]

Measurement

16.5 Investment property is measured on initial recognition at its cost. Cost comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other transaction costs. [FRS102.16.5] When payment is deferred beyond normal credit terms, the cost is calculated as the present value of all future payments. The cost of a self-constructed investment property is calculated in accordance with Section 17.

16.6 Investment property whose fair value can be measured reliably without undue cost or effort is measured at fair value at each reporting date, with changes in fair value recognised in profit or loss. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Investment properties are not depreciated. The Companies Act requires that all tangible fixed assets are depreciated; therefore, compliance with the non-depreciation requirements of FRS 102 will require the true and fair override provisions of the Act to be invoked. FRS 102.3.5 indicates that it is possible to depart from the requirements of legislation when compliance with those requirements would be misleading. The entity is required to provide particulars of that departure, the reasons for it and its effect in the notes to the accounts. See paragraph 3.55 of this publication.

16.7 All other investment property is accounted for as property, plant and equipment using the cost model under Section 17, which requires depreciation of the property. [FRS102.16.7]

16.8 In practice it is unlikely that investment property in the UK would be difficult to measure at fair value. What level of cost or effort is regarded as ‘undue’ will be a judgement depending on the facts. See paragraph 11.25 of this publication for guidance on fair value.

Transfers

16.9 If a reliable measure of fair value is no longer available without undue cost or effort for an item of investment property measured using the fair value model, the entity then accounts for that item as property, plant and equipment in accordance with Section 17 until a reliable measure of fair value becomes available. The carrying amount of the investment property on that date becomes its cost under Section 17. Disclosure is made of this change, which is a change of circumstances and not a change in accounting policy. [FRS102.16.8]

16.10 Other than as required by paragraph 16.9 of this publication, transfers of property to, or from, investment property are permitted only when the property first meets, or ceases to meet, the definition of investment property. [FRS102.16.9]
Property, plant and equipment
Overview of requirements

- Property, plant and equipment (PP&E) is recognised as an asset only when the flow of future economic benefits to the entity associated with the item is probable, and its cost can be measured reliably.

- Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

- PP&E is measured at cost on initial recognition. Cost includes amounts directly attributable to bringing the asset to the location and condition necessary for it to operate in the manner intended by management. The cost is discounted to present value when payment terms are deferred. Borrowing costs may be capitalised in accordance with Section 25 Borrowing costs.

- After initial recognition, PP&E is measured either at cost less any accumulated depreciation and any accumulated impairment losses, or at fair value with changes in fair value generally recognised through other comprehensive income.

- The depreciable amount of an asset is allocated to profit or loss on a systematic basis over the asset’s useful life unless another section of the FRS requires the cost to be recognised as part of the cost of an asset.

- When indicators of impairment exist, PP&E is tested for impairment in accordance with Section 27 Impairment of assets.

- PP&E is derecognised on disposal, or when no future economic benefits are expected from its use or disposal. Any gain or loss on derecognition is included in profit or loss when the item is derecognised.
FRS 15.53 indicates that most PP&E will be valued at existing use value, which is not necessarily the same as fair value.

Interest methods of depreciation such as ‘annuity’ depreciation are sometimes used, for example by some operating lessors.

Provided certain conditions are met, ‘renewals accounting’ may be adopted under FRS 15. Under renewals accounting, an infrastructure system or network may be treated as a single asset with the depreciation charge estimated as being equal to the level of annual expenditure calculated as being required to maintain the operating capacity of the asset. Actual expenditure is capitalised as incurred. The use of renewals accounting is most common in utility companies. This approach is not permitted by FRS 102.

Tangible fixed assets other than non-depreciable land are reviewed for impairment at the end of each reporting period if no depreciation charge is made on the grounds that it would be immaterial, or if the estimated remaining useful economic life of the asset exceeds 50 years.

A review of the useful life and, if material, the residual value is performed annually whilst FRS 102.17.22 requires a review to take place only when indicators of a change in useful life or residual value exist. Under FRS 15, changes in market price do not affect residual value, since it is assessed at the date of acquisition; an asset measured at valuation is assessed at the latest revaluation date.

Under FRS 15, revaluation decreases are recognised in profit or loss when they are caused by a clear consumption of economic benefits. Otherwise they are recognised in the statement of total recognised gains and losses (STRGL) until the asset’s carrying amount equals its depreciated historical cost, and then in profit or loss. However, the loss is also recognised in the STRGL rather than in profit or loss to the extent that the recoverable amount of the asset is greater than its revalued amount i.e. value in use exceeds net realisable value.

UITF 5 covers the treatment of assets transferred from current to fixed. Current asset accounting rules are applied up to the date of transfer (which is not backdated) i.e. when management’s intent for the asset changed. The transfer is made at the lower of cost and net realisable value (NRV) with any differences in the carrying value taken to profit or loss. After the transfer date fixed asset accounting rules apply. Assets transferred at NRV are accounted for as fixed assets at valuation; at subsequent balance sheet dates these assets need not be revalued but the disclosure requirements for assets held at valuation still apply. There is no specific guidance under FRS 102 but FRS 102.17.13 states that ‘cost’ of PP&E is the cash price equivalent at recognition date. Therefore, if the value of the item had increased during the period it was held as inventory, it would be recognised at a higher value under FRS 102 than previous UK GAAP.
**FRS 102**

**Section 17**

17.1 Property, plant and equipment are tangible assets that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period. [FRS102.17.2]

17.2 Property, plant and equipment does not include:

(a) biological assets related to agricultural activity or heritage assets (see Section 34 Specialised activities); or

(b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources; or [FRS102.17.3]

(c) investment property whose fair value can be measured reliably without undue cost or effort (see Section 16 Investment property). Investment property whose fair value cannot be measured reliably without undue cost or effort is accounted for as property, plant and equipment under this section. [FRS102.17.1]

**Recognition**

17.3 An item of property, plant and equipment (PP&E) is recognised as an asset only when the flow of future economic benefits to the entity associated with the item is probable, and its cost can be measured reliably. [FRS102.17.4]

17.4 The classification of spare parts and servicing equipment depends on how and when it will be used. Usually it will be carried as inventory and recognised in profit or loss as it is consumed. However, when the expectation is that it will be used over more than one period, or if it can be used only in connection with an item of PP&E, then it will be classified as PP&E. [FRS102.17.5]

17.5 The cost of replacing parts of PP&E that require replacement at regular intervals (e.g. the roof of a building) is added to the carrying amount of the asset when incurred, if the replacement part is expected to provide incremental future benefits to the entity. The carrying amount of the parts that are replaced is derecognised. If the major components of an item of PP&E have significantly different useful life patterns, the initial cost of the asset is allocated to its major components and each component is depreciated separately over its useful life. [FRS102.17.6]

17.6 In order to continue to use an item of PP&E (e.g. a bus) an entity may be required to perform regular major inspections for faults. The cost of a major inspection is added to the cost of the asset as a replacement, if the recognition criteria are satisfied. The carrying amount of the previous major inspection (as distinct from physical parts) is derecognised. If the cost of the previous major inspection was not identified when the asset was acquired or constructed, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed. [FRS102.17.7]

17.7 Land and buildings are separable assets and are accounted for separately, even when they are acquired together. [FRS102.17.8]

**Measurement at recognition**

17.8 PP&E is measured at cost on initial recognition. [FRS102.17.9]

17.9 The cost of an item of PP&E comprises all of the following:

(a) its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. These can include the costs of site preparation, initial delivery and handling, installation and assembly, and testing of functionality;

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period; and

(d) any borrowing costs capitalised in accordance with Section 25 Borrowing costs. [FRS102.17.10]
IRFS17.1 PP&E that is held for sale is excluded from the scope of IAS 16 and is accounted for in accordance with IFRS 5. Under that standard, a non-current asset or disposal group held for sale is carried at the lower of carrying amount and fair value less costs to sell and is disclosed within current assets.

IRFS17.2 Borrowing costs directly attributable to the construction or acquisition of PP&E are required to be capitalised as part of its cost.

IRFS17.3 A review of the residual value, useful life and depreciation methods used is performed at least at each financial year end.
17.10 The following expenses do not form part of the cost of PP&E, and are recognised as an expense when they are incurred:

(a) costs of opening a new facility;
(b) costs of introducing a new product or service (including costs of advertising and promotional activities);
(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training);
(d) administration and other general overhead costs. [FRS102.17.11]

17.11 The income and related expenses of incidental operations during construction or development of an item of PP&E are recognised in profit or loss if those operations are not necessary to bring the item to its intended location and operating condition. [FRS102.17.12]

17.12 The cost of an item of PP&E is discounted to present value when payment terms are deferred. [FRS102.17.13]

17.13 When an asset is acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets the cost of the acquired asset is considered to be the fair value of the consideration. However, if the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is measurable reliably the asset’s cost is measured at the carrying amount of the asset given up. [FRS102.17.14]

Measurement after initial recognition

17.14 After initial recognition, PP&E is measured using either the cost model or the revaluation model. When using the revaluation model an entity applies it consistently to all items of PP&E in the same class. The day-to-day costs of servicing an item of PP&E are recognised in profit or loss in the period in which the costs are incurred. [FRS102.17.15]

Cost model

17.15 Under the cost model, PP&E is measured at cost less any accumulated depreciation and impairment losses. [FRS102.17.15A]

Revaluation model

17.16 Under the revaluation model, PP&E is carried at fair value (revalued amount) less any subsequent accumulated depreciation and accumulated impairment losses. Assets are revalued with sufficient frequency to ensure that the carrying amount does not differ materially from the fair value at the end of the reporting period. [FRS102.17.15B]

17.17 Fair value is usually determined by a market-based appraisal. The valuation of land and buildings is normally undertaken by professional valuers. If there is no market-based evidence, e.g. for specialised assets, the entity may need to use an income or depreciated replacement cost approach to estimate fair value. [FRS102.17.15C,D] See paragraph 11.25 of this publication for guidance on fair value.

17.18 Revaluation increases are recognised in other comprehensive income (OCI), except to the extent that they reverse a revaluation decrease that was previously recognised in profit or loss, in which case they are also recognised in profit or loss. Revaluation gains are recognised in a separate revaluation reserve in equity. Revaluation decreases are recognised in OCI to the extent they reverse a previous revaluation increase in relation to the same asset, and are otherwise recognised in profit or loss. [FRS102.17.15E,F]

Depreciation

17.19 When the major components of an item of PP&E have significantly different useful economic life patterns, the initial cost of the asset is allocated to each major component. Each component is depreciated separately over its useful life. Other assets are depreciated over their useful lives as single assets. Land has an unlimited useful life and is not depreciated, except for land assets such as quarries and sites used for landfill, which do have limited useful lives and are therefore depreciated. [FRS102.17.16]

17.20 The depreciation charge is recognised in profit or loss unless another section of FRS 102 requires the cost to be recognised as part of the cost of an asset. For example, the depreciation of manufacturing PP&E is included in the cost of inventories (see Section 13 Inventories). [FRS102.17.17]
The depreciable amount of an asset (being its cost or valuation, less its residual value) is allocated on a systematic basis over its useful life. [FRS102.17.18] The residual value and/or the useful life of an asset can be affected by factors such as a change in how an asset is used, significant unexpected wear and tear, technological advances or a change in market prices. These factors may indicate that the residual value or useful life of an asset has changed since the most recent annual reporting date. If such indicators are present, an entity reviews its previous estimates and, if current expectations differ, amends the residual value, depreciation method or useful life. Changes in the residual value, depreciation method or useful life are accounted for as a change in an accounting estimate (see Section 10 Accounting policies, estimates and errors). [FRS102.17.19]

Depreciation begins when the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production. [FRS102.17.20]

The following factors are considered when determining the useful life of an asset:
(a) the expected usage of the asset. Usage is assessed by reference to the asset’s expected capacity or physical output;
(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle;
(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset;
(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases. [FRS102.17.21]

A depreciation method is selected that reflects the pattern in which the asset’s future economic benefits will be consumed. Possible methods include the straight-line method, the diminishing balance method and a method based on usage, such as the units of production method. [FRS102.17.22]

When there is an indication that the asset’s usage pattern has changed significantly since the last reporting date, the depreciation method is reviewed. If current expectations differ, the depreciation method is changed to reflect the new pattern. The change is accounted for as a change in an accounting estimate. [FRS102.17.23]

The requirements of Section 27 Impairment of assets apply at each reporting date in assessing whether an item of PP&E is impaired. That section notes that a plan to dispose of an asset earlier than previously expected is an indicator of impairment triggering the need to calculate its recoverable amount. [FRS102.17.24,26]

Any compensation for impairment from third parties for items of PP&E that were impaired, lost or given up is recognised in profit or loss only when the compensation is virtually certain to be received. [FRS102.17.25]

An item of PP&E is derecognised on disposal, or when no future economic benefits are expected from its use or disposal. [FRS102.17.27] A gain or loss on derecognition is included in profit or loss when the item is derecognised, unless the transaction is a sale and leaseback to which the requirements of Section 20 Leases apply. Gains on derecognition are not classified as revenue. [FRS102.17.28]

The disposal date of an item is determined by applying the criteria for recognising revenue from the sale of goods in Section 23 Revenue, except for a sale and leaseback disposal, to which Section 20 applies. [FRS102.17.29]

The gain or loss arising from the derecognition of an item of PP&E is the difference between the net disposal proceeds and the carrying amount of the item. [FRS102.17.30]

Qualifying entities applying FRS 102 are exempt from certain disclosure requirements of Section 17. See paragraph 3.7 of this publication.
Intangible assets other than goodwill
Overview of requirements

• An intangible asset is an identifiable non-monetary asset without physical substance.

• An intangible asset is identifiable if it is separable or arises from contractual or legal rights.

• An intangible asset acquired in a business combination is recognised separately from goodwill unless it arises from legal or contractual rights, transactions in similar assets are not seen and its fair value cannot be estimated without using immeasurable variables.

• Costs of internally generated intangible assets are split between those incurred during the research phase and those incurred in the development phase. Costs incurred during the research phase are expensed as incurred. Costs incurred in the development phase may be capitalised (an accounting policy choice) but only if certain conditions are met.

• Expenditure on internally generated brands and logos, start-up activities, training, advertising and promotion, relocation of the entity and internally generated goodwill is expensed as incurred.

• Other separately acquired intangibles are recognised in the balance sheet when it is probable that future economic benefits will flow to the entity and their cost or value can be measured reliably.

• Intangible assets are measured initially at cost, which is a valuation if they are acquired in a business combination, by way of government grant or by way of an exchange of non-monetary assets.

• Intangible assets are subsequently measured either at cost, or (if criteria are met) at fair value, less accumulated amortisation and impairment losses. Any revaluation gains or losses whilst the fair value remains above cost are recognised in other comprehensive income; gains or losses when fair value is below cost are recorded in the profit and loss account.

• All intangible assets are considered to have a finite useful life. The useful life is presumed to not exceed five years unless a reliable estimate of the useful life can be made.
The recognition criteria for intangible assets under FRS 10 are different from those in FRS 102:

- An item acquired in a business combination that would otherwise be an intangible asset but is not separable (i.e. it cannot be sold or transferred without disposing of a business of the entity) is accounted for as part of goodwill.
- If an intangible asset acquired as part of the acquisition of a business does not have a readily ascertainable market value (defined in a similar way to an active market), its fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition.

There is a rebuttable presumption that the useful economic lives of intangible assets are limited to a maximum of 20 years. This presumption can be rebutted only if the durability of the acquired business or intangible asset can be demonstrated and the goodwill or intangible asset is capable of continued measurement. In such cases, the useful economic life may be indefinite.

Intangible assets are tested for impairment annually if they are amortised over a period longer than 20 years or are not amortised. A separate impairment test is carried out at the end of the first full year after their acquisition.
18 Intangible assets other than goodwill

FRS 102
Section 18

Scope
18.1 Section 18 _Intangible assets other than goodwill_ applies to the accounting for all intangible assets except:

- goodwill – see Section 19 _Business combinations and goodwill_;
- intangible assets held by an entity for sale in the ordinary course of business – see Section 13 _Inventories_ and Section 23 _Revenue_;
- heritage assets – see Section 34 _Specialised activities_;
- deferred acquisition costs and other assets in the scope of FRS 103 _Insurance contracts_ (once issued); and
- mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources – see Section 34 [FRS102.18.1,1A,3]

Definition
18.2 An intangible asset is an identifiable non-monetary asset without physical substance. Such an asset is identifiable when:

(a) it is separable, i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
(b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations. [FRS102.18.2]

Recognition
18.3 An intangible asset is recognised when it is probable that the entity will receive the expected future economic benefits attributable to the asset, and its cost or value can be measured reliably. [FRS102.18.4]

18.4 Management uses judgement and reasonable assumptions to assess the degree of certainty attached to expected future economic benefits attributable to an asset. More weight is given to external evidence. [FRS102.18.5,6]

18.5 When an intangible asset is acquired separately it is always considered probable that future economic benefits will flow to the entity. [FRS102.18.7]

18.6 When acquired as part of a business combination an intangible asset’s fair value (see paragraph 11.25 of this publication for guidance) can usually be measured reliably and therefore the asset is recognised. However, an intangible asset acquired in a business combination is not recognised when it arises from legal or other contractual rights and: there is no history or evidence of exchange transactions for the same or similar assets; and otherwise estimating fair value would be dependent on immeasurable variables. [FRS102.18.8]

Initial measurement
18.7 Intangible assets are measured initially at cost. [FRS102.18.9]

18.8 The cost of an intangible asset is determined as follows:

- For a separately acquired intangible asset, cost comprises purchase price including import duties and non-refundable purchase taxes but net of trade discounts and rebates, and any costs directly attributable to preparing the asset for its intended use. [FRS102.18.10]
- For an internally generated intangible asset, cost comprises the directly attributable costs incurred after a certain point in the project (see paragraphs 18.14 to 18.16 of this publication). [FRS102.18.10A]
- For an intangible asset acquired in a business combination, cost is the asset’s fair value at the acquisition date. [FRS102.18.11]
- For an intangible asset acquired by way of a grant, cost is the asset’s fair value on the date the grant is received or receivable. [FRS102.18.12]
- For an intangible asset acquired through an exchange of non-monetary assets, cost is the asset’s fair value unless the transaction lacks commercial substance or the fair value of both the asset(s) given up and the asset(s) received cannot be measured reliably. In that case, the carrying amount of the asset given up is used as the cost of the intangible asset acquired. [FRS102.18.13]
vs EU-IFRS

Applicable standards: IAS 20, IAS 38, SIC 32, IFRS 3

IFRS18.1 Under IAS 38, expenditure on certain internally generated intangibles (i.e. development costs meeting specified criteria) are capitalised; there is no accounting policy choice.

IFRS18.2 Borrowing costs directly attributable to the production of a qualifying intangible asset are capitalised as part of its cost; again, there is no accounting policy choice.

IFRS18.3 When intangible assets are acquired free of charge or for nominal consideration by way of a government grant, in accordance with IAS 20 the assets can be recognised initially either at their fair value or at the nominal consideration.

IFRS18.4 Intangible assets may be considered to have a finite or indefinite useful life under IAS 38. Intangible assets with an indefinite useful life are not amortised. Intangible assets that are not subject to amortisation (e.g. intangible assets with an indefinite life or those assets not yet in use) are tested annually for impairment. Goodwill is not amortised.

IFRS18.5 FRS 102.18.8 refers to non-recognition of an intangible asset acquired in a business combination when the fair value of an intangible asset arising from contractual or legal rights cannot be measured reliably because there is a lack of exchange transactions. Under EU-IFRS, if an intangible asset acquired as part of a business combination is separable or arises from contractual or other legal rights then sufficient information is deemed to exist to measure its fair value reliably.
**Internally generated intangible assets**

18.9 In assessing whether the recognition criteria are met for an internally generated intangible asset, its generation is split into a research phase and a development phase, defined as:

- Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
- Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

18.10 If an entity cannot distinguish between the two phases then all expenditure on the project is treated as relating to the research phase. [FRS102.18.8B]

18.11 Expenditure relating to the research phase of a project is expensed as incurred. Examples of research activities include obtaining new knowledge, and searching for and evaluating alternative materials, products, processes, systems or services. [FRS102.18.8G]

18.12 Other examples of expenditure that are expensed rather than recognised as an intangible asset, include expenditure on:

(a) internally generated brands, logos, publishing titles and customer lists;
(b) start-up activities, including for example legal and secretarial costs incurred in establishing a legal entity, pre-opening costs of a new facility or business and expenditure for starting new operations or launching new products or processes (i.e. pre-operating costs);
(c) training activities;
(d) advertising and promotional activities (but see paragraph 13.4 of this publication in relation to inventories of, for example, marketing materials);
(e) relocating or reorganising part of an entity; and
(f) internally generated goodwill. [FRS102.18.8C]

18.13 On the other hand, examples of development activities include:

(a) the design, construction and testing of pre-production prototypes;
(b) the design of tools, jigs, moulds, etc using new technology;
(c) pilot plants; and
(d) designing alternative materials, products, processes, systems or services. [FRS102.18.8J]

18.14 An entity makes an accounting policy choice to capitalise expenditure in the development phase as an intangible asset or recognise it as an expense. If it adopts a policy of capitalisation this applies to a development if, and only if, the entity can demonstrate that a series of criteria have all been met. These are:

(a) the project is technically feasible;
(b) the entity intends to complete the project and use or sell the intangible asset;
(c) the entity is able to sell or use the asset;
(d) it is probable that the asset will generate future economic benefits;
(e) the entity has sufficient resources to complete the project; and
(f) the entity can measure reliably the directly attributable expenditure. [FRS102.18.8H]
18.15 If these criteria are met then from the date at which these criteria are met, all costs that are directly attributable to creating, producing, and preparing the asset to be capable of operating in the manner intended by management are capitalised. [FRS102.18.10A,10B]

18.16 Directly attributable costs include the costs of materials, services and employees used to generate the asset. They also include legal registration fees and the amortisation of licences and patents used in generating the intangible asset. Borrowing costs are capitalised when the entity has adopted a policy of capitalising borrowing costs for qualifying assets in line with Section 25 Borrowing costs. [FRS102.18.10B]

18.17 If these requirements are not met, or a policy of capitalisation of development expenditure is not adopted, the costs are expensed in profit or loss as incurred. [FRS102.18.8K]

18.18 Expenditure that has been expensed cannot be ‘revived’ and capitalised at a later date as part of the cost of an asset. [FRS102.18.17]

**Subsequent measurement**

18.19 Intangible assets are measured after initial recognition using either:

- the cost model; or
- the revaluation model, provided that fair value can be determined by reference to an active market. The revaluation model is applied consistently to all such intangible assets of the same class. [FRS102.18.18]

18.20 An active market is one in which willing buyers and sellers normally can be found at any time for items that are homogeneous and for which prices are available to the public. By requiring the fair value to be measured with reference to an active market, FRS 102 therefore requires a high threshold to be met for entities to be able to apply the revaluation model.

**Cost model**

18.21 Under the cost model, intangible assets are measured at cost less any accumulated amortisation and impairment losses. [FRS102.18.18A]

**Revaluation model**

18.22 Under the revaluation model, an intangible asset is carried at its fair value (revalued amount) less any subsequent accumulated amortisation and impairment losses. Fair value is determined by reference to an active market. Assets are revalued with sufficient frequency that the revalued amount does not differ materially from the fair value at the period end. [FRS102.18.18B,18D]

18.23 Revaluation gains and losses relating to an asset are recorded in profit or loss while the fair value of that asset is above cost and other comprehensive income (OCI) otherwise. Revaluation gains or losses recognised in OCI are recorded in equity.

18.24 When an active market for an intangible no longer exists, its carrying value is its last revaluation less accumulated amortisation and impairment. [FRS102.18.18E]

18.25 The revaluation model is applied after the asset has been measured initially at cost and does not permit either the revaluation of intangible assets that have not been previously recognised, or the initial recognition of an intangible asset at an amount other than cost. [FRS102.18.18C]

**Amortisation and useful life**

18.26 All intangible assets are considered to have a finite useful life. For intangible assets arising from contractual or legal rights, the useful life does not exceed the period of the contractual or legal rights, although it may be shorter if the period over which the entity expects to use the asset is shorter. If the contractual or legal rights can be renewed, the useful life of the intangible asset includes the renewal period only if there is evidence to support renewal by the entity without significant cost. [FRS102.18.19]

18.27 The useful life of an intangible asset is presumed to be no more than five years unless a reliable estimate of its life can be made. [FRS102.18.20]
The depreciable amount of an intangible asset is allocated on a systematic basis over its useful life. Amortisation commences when the intangible asset is available for use. An asset is available for use when it is in the location and condition necessary for it to be used in the manner intended by management. An amortisation method is chosen that reflects the pattern of expected consumption of the asset’s future economic benefits. If a pattern of consumption cannot be determined reliably the straight-line method is used.

The amortisation charge is expensed, unless it is required by another section of FRS 102 to be recognised as part of the cost of an asset such as inventory.

It is assumed that the residual value of an intangible asset is zero unless either a third party is committed to purchase the asset at the end of its useful life or the residual value can be determined by reference to an active market and it is probable that such a market will exist at the end of the asset’s useful life.

Indicators such as technological advancement, changes in market prices or a change in the use of an intangible asset may provide evidence that the useful life or residual value has changed in the reporting period. When such indicators exist, the estimates of residual value, useful life or amortisation method are reviewed and amended as appropriate. Changes are accounted for prospectively as a change in accounting estimate.

Impairment losses

An entity applies Section 27 Impairment of assets to determine whether an intangible asset is impaired.

Derecognition

Intangible assets are derecognised on disposal or when no future economic benefits are expected from the asset’s use or disposal. Any resultant gain or loss is recognised in profit or loss.
Business combinations and goodwill
Overview of requirements

• A business combination is the bringing together of separate entities or businesses into one reporting entity.

• The acquisition date is the date on which the acquirer obtains control of the acquiree.

• Merger accounting may be applied for group reconstructions and public benefit entity (PBE) combinations that are a merger provided certain criteria are met. Under merger accounting the carrying values of the assets and liabilities are not adjusted to fair value.

• Business combinations (other than group reconstructions and PBE combinations that are either a merger or in substance a gift) are accounted for using the purchase method as described below.

• The combining entity that obtains control of the other combining entities or businesses is identified as the acquirer.

• The cost of a business combination is measured at fair value at the acquisition date and includes any directly attributable costs. Contingent consideration is included in the cost at its estimated amount and is subsequently trued-up with any adjustments taken to goodwill.

• The acquirer allocates the cost of the business combination by recognising at their fair value the acquiree’s identifiable assets, liabilities and contingent liabilities, save that deferred tax, employee benefit arrangements, and share-based payments are measured in accordance with their relevant standards.

• The difference between the cost of the business combination and the acquirer’s interest in the net fair value of the acquiree’s assets, liabilities and recognised contingent liabilities is accounted for as goodwill or ‘negative goodwill’.

• After acquisition, goodwill is measured at cost less accumulated amortisation and impairment losses. The presumed life of goodwill is five years or less, unless a longer (but finite) useful life can be supported.

• Negative goodwill is recognised initially in the balance sheet and subsequently in profit or loss, primarily in the period in which the acquired non-monetary assets are recovered.

• If the initial accounting for a business combination is incomplete at the reporting date, provisional amounts are recognised for the items for which it is incomplete. If additional information becomes available about the acquisition date values of those items in the 12 months after the acquisition date, the initial accounting is adjusted retrospectively (i.e. restated) to reflect that new information.
The general principles for establishing the cost of acquisition and the fair value of the assets and liabilities applying the purchase method of accounting for a business combination are similar to FRS 102 although there are a number of differences in the detail. These include the following:

- FRS 7 includes guidance on the determination of the fair values of specific items in a business combination. FRS 102 contains little guidance in this area.
- Deferred tax is generally not recognised on fair value adjustments in a business combination due to the different approach to deferred tax accounting under previous UK GAAP.
- There are detailed differences in the criteria for recognising intangible assets separately from goodwill on acquisition. For example, FRS 10.2 states that to be identifiable an intangible asset has to be separable; and that if the benefits embodied in an intangible asset are not controlled through legal rights or custody, an entity does not have sufficient control to recognise an intangible asset.
- If an intangible asset recognised separately from goodwill does not have a readily ascertainable market value, its fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition.
- Adjustments to provisional fair values and corresponding adjustments to goodwill are made prospectively (i.e. there is no prior year adjustment).
- Adjustments to provisional fair values may be made at any time in the financial statements in the period following that in which the acquisition was completed.

There is a rebuttable presumption in FRS 10 that the useful economic life of goodwill is no more than 20 years. This presumption can be rebutted only if the durability of the acquired business or intangible asset can be demonstrated and the goodwill is capable of continued measurement.

Goodwill is tested for impairment annually if it is either amortised over a period longer than 20 years, or is not amortised due to having been attributed an indefinite life.
19.1 This section discusses the accounting for all business combinations except for the formation of joint ventures and public benefit entity combinations (see Chapters 15 and 34J of this publication respectively). [FRS102.19.2, FRS102.PBE19.2A]

Definition

19.2 A business combination is the bringing together of separate entities or businesses into one reporting entity. [FRS102.19.3] A business is defined as an integrated set of activities and assets conducted and managed for the purpose of providing a return to investors or lower costs or other economic benefits directly and proportionately to policyholders or participants. [FRS102.GL]

Purchase method

19.3 Business combinations are accounted for using the purchase method unless they are group reconstructions, which may be accounted for by applying the merger accounting method provided certain conditions are met (see paragraph 19.27 of this publication). The purchase method involves:

   (a) identification of an acquirer;
   (b) measurement of the cost of the business combination; and
   (c) allocation, at the acquisition date, of the cost of the business combination to the assets acquired and liabilities and provisions for contingent liabilities assumed. [FRS102.19.7]

Identifying the acquirer

19.4 Under FRS 102, one party is always identified as the acquirer. [FRS102.19.8] The combining entity that obtains control of the other combining entities or businesses is the acquirer. [FRS102.19.8] Control is defined as the power to govern the financial and operating policies of an entity so as to benefit from its activities. [FRS102.GL] Indicators that an entity is the acquirer include:

   (a) the entity’s fair value is significantly greater than the other;
   (b) the entity gives up cash or other assets as consideration for voting ordinary equity instruments of the other;
   (c) the entity’s management team dominated the selection of the management team of the combined entity. [FRS102.19.10]

Acquisition date

19.6 The acquisition date is the date the acquirer obtains control of the acquiree. [FRS102.19.17] It may not be necessary for a transaction to be finalised at law for the acquirer to obtain control.

Cost of a business combination

19.7 The acquirer measures the cost of a business combination as the aggregate of:

   (a) the fair values, at the acquisition date, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus
   (b) any costs directly attributable to the business combination. [FRS102.19.11]

19.8 If the cost of a business combination includes an element of consideration contingent on future events, the acquirer estimates and includes that element of consideration in the cost of the business combination if it is considered probable that it will be paid and it can be measured reliably. [FRS102.19.12] If payment of an additional amount of contingent consideration subsequently becomes probable or measurable reliably, it is treated as an adjustment to the cost of the combination. [FRS102.19.13] There is no time limit for this adjustment.

19.9 FRS 102 does not specifically address other movements in the amount recorded as a contingent consideration liability. For example, it does not consider movements that arise because payment of contingent consideration is no longer considered probable. Recognising such changes as an adjustment to goodwill would be consistent with both IFRS 3 (2004) and FRS 7 and the treatment in FRS 102.19.13.
There are a number of differences between the requirements of FRS 102 and IFRS. For some of these, the difference may be in the detail. The most significant differences are set out below.

Transaction costs, other than share and debt issue costs, are expensed as incurred.

Contingent consideration is measured initially at fair value. The probability of all potential outcomes is taken into account in determining the fair value of the liability, but probability is not itself a recognition threshold. Contingent consideration is classified as a liability or as equity in accordance with IAS 32. Liability-classified contingent consideration is measured at fair value with adjustments in comprehensive income. Contingent consideration that is classified as equity is not remeasured and any difference on settlement is accounted for in equity.

IFRS 3 has specific rules whereby the consideration is adjusted when the combination effectively settles a pre-existing relationship, e.g. a lease, between the acquirer and the acquiree. For example, with a pre-existing lease the consideration is increased/reduced by the amount that would be received/paid by the acquirer to settle the outstanding lease contract at fair value.

IFRS 3 includes detailed and sometimes prescriptive guidance on how to determine whether part of a payment relates to future services. Consideration paid excludes amounts that are treated as payments to vendors for future services.

The fair values of previously held interests are added to consideration in determining goodwill. Any difference between the fair and book values of previously held interests are recorded in profit or loss at the acquisition date.

Similarly to FRS 102, there are a number of exceptions in IFRS 3 to the requirement to measure acquired assets and liabilities at fair value. However, IFRS 3 includes detailed rules, setting out the treatment of many of these assets and liabilities, that are not replicated in FRS 102. For example, there are specific rules about the treatment of share-based payment awards in IFRS 3 that are not repeated in FRS 102. In addition, IFRS 3 exempts some contingent liabilities, indemnification assets and reacquired rights from the requirement to be measured at fair value on acquisition.

There is a transaction-by-transaction option to measure any non-controlling interest initially either at its proportionate share of the net assets acquired, as in FRS 102, or at its fair value with a consequential increase in goodwill (in fact, producing a goodwill figure as if 100 percent of the acquiree had been acquired).

Goodwill is not amortised but is tested for impairment (at least) annually.

Any bargain purchase gain (i.e. negative goodwill) is recognised in profit or loss at acquisition.

The definition of group reconstructions under FRS 102 is different from the definition of business combinations under common control in IFRS 3. For example, a transaction in which the controlling party remained the same but for which there was a significant change in the non-controlling interest would be a common control combination but would not qualify as a group reconstruction.

Common control combinations are scoped out of IFRS 3 and entities are often able to make an accounting policy choice between book value and IFRS 3 acquisition accounting. Whilst this choice is similar to that available for group reconstructions in FRS 102, the lack of guidance on how common control combinations are dealt with in IFRS may result in a wider choice of accounting outcomes being available. A more detailed discussion of the accounting for common control combinations under IFRS can be found in chapter 5.13 of the KPMG publication, *Insights into IFRS*. 
Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed

19.10 The acquirer records the assets and liabilities and contingent liabilities that it has acquired as follows. For an acquiree’s intangible asset or contingent liability to be recognised it is necessary only that its fair value can be measured reliably. For any other asset/liability (other than deferred tax, employee benefits and share-based payments, see paragraphs 19.13 to 19.14 of this publication), in addition to the need for reliable measurement at fair value, it also has to be probable that future benefits/resources will flow to/from the entity to recognise the asset or liability. [FRS102.19.15]

19.11 Only assets, liabilities and contingent liabilities that existed at the acquisition date and satisfy the recognition criteria (described in the preceding paragraph) are recognised. As such, restructuring or downsizing costs are recognised as part of the acquisition only when the acquiree had an existing liability for restructuring in accordance with Section 21 Provisions and contingencies at the acquisition date. Future losses or other costs expected to be incurred as a result of the business combination are not recognised as liabilities by the acquirer on acquisition. [FRS102.19.18]

19.12 At the acquisition date, the acquiree’s identifiable assets and liabilities and contingent liabilities that satisfy the recognition criteria are brought in at their fair values at that date. The differences between the cost of the business combination and the acquirer’s interest in the net fair value (i.e. net of any non-controlling interest’s share, see paragraph 9.32 of this publication) of the identifiable assets, liabilities and recognised contingent liabilities is accounted for as goodwill or so-called ‘negative goodwill’. [FRS102.19.14] Special rules exist for the calculation of goodwill in a step acquisition (see paragraph 19.26 of this publication).

19.13 At the acquisition date, the acquirer recognises and measures deferred tax assets and liabilities arising from the assets acquired and liabilities assumed in accordance with Section 29 Income tax. Deferred tax is recognised in respect of any additional tax consequences of any differences between the amount that will be deducted or assessed for tax and the fair value of acquired assets and liabilities. No deferred tax is recognised, however, on the initial recognition of goodwill. [FRS102.29.15A]

19.14 If the acquiree has any employee benefit arrangements, the acquirer recognises and measures any assets or liabilities related to those arrangements at the acquisition date in accordance with Section 28 Employee benefits. [FRS102.19.15B] Similarly, share-based payments are recognised and measured in accordance with Section 26 Share-based payment. [FRS102.19.15C]

19.15 Post acquisition, the results of the acquiree are included in the acquirer’s statement of comprehensive income based on the fair values recognised at the acquisition date. For example, depreciation of property, plant and equipment is calculated based on its acquisition date fair value, which is treated as its cost to the acquirer. [FRS102.19.16]

19.16 In particular, the acquirer subsequently measures contingent liabilities at the higher of:

(a) the amount that would be recognised in accordance with Section 21; and

(b) the amount recognised initially less amounts previously recognised as revenue in accordance with Section 23 Revenue. [FRS102.19.21]

19.17 If the initial accounting for the business combination is incomplete at the end of the period in which the business combination took place, the acquirer recognises provisional amounts for the items for which the accounting is incomplete. It then has until 12 months from the acquisition date to make adjustments to those amounts to reflect new information obtained about the acquisition date fair value of those assets and liabilities. Such adjustments are made as at the original acquisition date, i.e. by restating the prior year if the acquisition took place in the prior year.

19.18 Beyond 12 months, adjustments to the initial accounting for a business combination are recognised only to correct an error in accordance with Section 10 Accounting policies, estimates and errors and in respect of the remeasurement of contingent consideration. [FRS102.19.19]

19.19 Whilst FRS 102.19.19 discusses hindsight period adjustment to ‘assets and liabilities’ acquired, it does not specifically refer to contingent liabilities recorded as part of the business combination. Since contingent liabilities are required to be recorded as a provision at the acquisition date (i.e. they are treated as a liability at that date), they would also be subject to the same hindsight period rules.

Goodwill

19.20 At the acquisition date, the acquirer recognises goodwill acquired in a business combination as an asset. It is measured as the excess of cost over the acquirer’s interest in the net fair value of the assets, liabilities and contingent liabilities recognised on acquisition (subject to specific rules for goodwill arising on a step acquisition - see paragraph 19.26 of this publication). [FRS102.19.22]
19.21 After initial recognition, goodwill is measured at cost less accumulated amortisation and accumulated impairment losses. Goodwill is amortised on a systematic basis over its useful life, which is considered to be finite. Goodwill has no residual value. [FRS102.18.23] If a reliable estimate of the useful life of goodwill cannot be made then it is presumed to be five years. The amortisation period and method are reviewed when events and circumstances indicate that the useful life may have changed since the last reporting date. Goodwill is tested for impairment in accordance with Section 27 Impairment of assets. [FRS102.19.23]

19.22 When the acquirer’s interest in the net fair value of the identifiable assets, liabilities and provisions for contingent liabilities acquired exceeds the cost of the business combination (sometimes referred to as ‘negative goodwill’), the acquirer:

(a) reassesses the identification and measurement of the acquiree’s assets, liabilities and provisions for contingent liabilities and the measurement of the cost of the combination;

(b) records any excess that remains after the reassessment on the balance sheet immediately below any positive goodwill (striking a net total of the positive and negative goodwill); and

(c) recognises the excess in profit or loss in the periods in which the non-monetary assets acquired are recovered. Any excess over the fair value of non-monetary assets acquired is recognised in profit or loss in the periods expected to benefit. [FRS102.19.24]

### Non-controlling interests

19.23 A non-controlling interest (NCI) is defined as the equity in the subsidiary not attributable directly or indirectly to the parent. NCI is recognised at the date of the acquisition as the NCI holders’ net interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree recognised at the acquisition date. See paragraphs 9.28 to 9.33 of this publication.

19.24 For example, on 31 October 20X1 company P acquires 60 percent of company S for cash of 1,000. The fair value of the identifiable net assets of S is 1,500. In its consolidated financial statements, P recognises the identifiable net assets of S at their fair value of 1,500, NCI of 600 (1,500 x 40%), and goodwill of 100 (1,000 - (1,500 x 60%)).

19.25 Note that the amount recorded as NCI as a result of this calculation does not include any share of goodwill. Similarly, the goodwill reflects only the parent’s interest in the goodwill.

### Step acquisitions

19.26 An acquirer may gain control of an investee in which it previously held an interest (a step acquisition). The legal appendix to FRS 102 determines the accounting for such transactions. When the existing interest is no longer held at its original cost (e.g. because it has been impaired, remeasured to fair value or subject to equity accounting), the goodwill is calculated based on the difference between the cost and share of net assets acquired at each step of the transaction. Using this method, 100 percent of the identifiable net assets are recognised on acquisition and a revaluation reserve arises on the revaluation of the share of net assets previously held.

### Example

<table>
<thead>
<tr>
<th></th>
<th>Original Cost</th>
<th>Subsequent profit</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td>25</td>
<td>-</td>
<td>25</td>
</tr>
<tr>
<td>Share of net assets</td>
<td>175</td>
<td>10</td>
<td>185</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>200</strong></td>
<td><strong>10</strong></td>
<td><strong>210</strong></td>
</tr>
</tbody>
</table>

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Piranha paid 750 for the remaining 75%. The fair value of the net assets at that point was 840. Goodwill is calculated as:

<table>
<thead>
<tr>
<th>Already present in equity accounting</th>
<th>25</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price paid for 75% stake</td>
<td>750</td>
</tr>
<tr>
<td>75% of the fair value of net assets at that date (75% x 840)</td>
<td>(630)</td>
</tr>
<tr>
<td></td>
<td>120</td>
</tr>
<tr>
<td></td>
<td>145</td>
</tr>
</tbody>
</table>

Note that as part of the acquisition accounting the net assets underlying the equity accounting will be revalued from 185 (based on fair values at the date of becoming an associate plus subsequent share of profits) to 210 (840 x 25%, based on fair values at the date of obtaining control), i.e. revalued by 25.

The double entry is:

<table>
<thead>
<tr>
<th>Goodwill</th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets</td>
<td>840</td>
<td></td>
</tr>
<tr>
<td>Cash paid</td>
<td></td>
<td>750</td>
</tr>
<tr>
<td>Investment in associate</td>
<td></td>
<td>210</td>
</tr>
<tr>
<td>Revaluation</td>
<td></td>
<td>25</td>
</tr>
</tbody>
</table>

The legal appendix to FRS 102 explains that this accounting is an instance of the true and fair override of the method provided in the Companies Act and FRS 102.19.11A. That method would have calculated goodwill as 110, being: the sum of the original cost of each tranche, 200 + 750 = 950; less the fair value of the net assets on acquiring control; i.e. 950 - 840 = 110. A goodwill figure of 110 is net of the revaluation credit of 25 and a reversal of the prior equity accounting profit of 10 (i.e. 145 - 25 - 10 = 110). The legal appendix explains that this method is required whenever the Act’s/FRS 102.19.11A’s method would be inconsistent with the way that the investment has previously been treated (which is likely to be the case whenever the investment is no longer recorded at the amount that it originally cost).

**Merger accounting**

19.27 Merger accounting may be used for a group reconstruction provided:

(a) merger accounting is not prohibited by applicable legislation;

(b) the ultimate equity holders and their relative rights remain the same; and

(c) any non-controlling interest in the net assets of the group remains unchanged. [FRS102.19.27]

19.28 A group reconstruction is any one of the following arrangements:

(a) the transfer of an equity holding in a subsidiary from one group entity to another;

(b) the addition of a new parent entity to a group;

(c) the transfer of equities in one or more subsidiaries of a group to a new entity that is not a group entity but whose equity holders are the same as those of the group’s parent; or

(d) the combination into a group of two or more entities that before the combination had the same equity holders. [FRS102.GL]
19.29 Under merger accounting:

- no fair value adjustments are made;  
- adjustments are required to align accounting policies; [FRS102.19.29]
- the results and cash flows of the combining entities are presented for the combined entity for the entire period in which the combination occurred. Comparatives are restated by including the results for all of the combining entities and their balance sheets at the previous balance sheet date; [FRS102.19.30]
- the difference between the nominal value of the shares issued (plus the fair value of other consideration) and the nominal value of the shares received is shown in the statement of changes in equity as a movement in other reserves;
- existing share premium or capital redemption reserve balances of the combined entity are subsumed in other reserves through the statement of changes in equity in the balance sheet of the combined entity; [FRS102.19.31]
- merger expenses are charged to profit or loss in the combined entity. [FRS102.19.32]

19.30 FRS 102 also observes that when a group reconstruction is effected using a newly formed parent company, the accounting treatment depends on the substance of the business combination being effected. Presumably this implies that if acquisition accounting was under consideration, then the newly formed parent would not take the role of acquirer. [FRS102.ACA.64]
Leases
Overview of requirements

- A lease is defined as an agreement whereby the lessor gives to the lessee the right to use an asset for an agreed period of time in return for a payment or series of payments.

- A finance lease transfers substantially all the risks and rewards of ownership to the lessee. An operating lease does not transfer substantially all the risks and rewards of ownership.

- Classification as a finance or operating lease depends on the substance of the transaction rather than the legal form of the lease and is determined at the start of the lease term.

- In the financial statements of lessees:
  - For finance leases, a right of use asset and finance lease liability are recognised at the fair value of the leased asset or, if lower, the present value of the minimum lease payments. The right of use asset is depreciated. A finance charge arises on the liability.
  - For operating leases, lease payments are recognised on a straight-line basis over the life of the lease unless another systematic basis is more appropriate, or lease payments increase with expected general inflation.

- In the financial statements of lessors:
  - For finance leases, a finance lease asset equal to the net investment in the lease is recognised. Lease payments received reflect both repayment of principal and finance income.
  - For operating leases, assets are presented and depreciated as property, plant and equipment. Lease payments received are generally recognised on a straight-line basis over the life of the lease. Property leased out under an operating lease is likely to be accounted for as investment property (see Section 16 Investment property).
  - When a manufacturer or dealer enters into a finance lease with its customers, this gives rise to immediate recognition of a sale and associated manufacturing profit together with finance lease income over the lease term. If a manufacturer or dealer enters into an operating lease with its customer, no sale is recognised but rental income is recognised over the lease term.

- Sale and leaseback transactions are considered together as they are typically interlinked. Specific accounting rules apply to these transactions.
Classification as a finance lease is presumed if the present value of the minimum lease payments is greater than or equal to 90 percent of the fair value of the asset.

UITF 28 contains specific guidance on accounting for operating lease incentives. Lease incentives are spread over the shorter of the lease term and the period ending on the date from which it is expected that the prevailing market rent will be payable. FRS 102 spreads the benefit over the lease term.

For a lessor accounting for finance leases under SSAP 21, the calculation of a constant periodic rate of return may take into account tax payments and receipts, including the effect of capital allowances, when arriving at the net cash investment in the lease.

When accounting for operating lease rentals, lease rentals that increase on an annual basis by fixed amounts that reflect inflation are accounted for on a straight-line or other systematic basis, in the same way as all other rental payments.

In an operating lease, some lessors apply interest-based methods of depreciation (e.g. annuity depreciation) to the leased asset; such methods are not permitted under FRS 102.

A sale and leaseback transaction resulting in a finance lease is generally accounted for as a borrowing, rather than a separate sale and finance lease. As such the carrying value of the asset will remain unchanged with no separate deferral of the excess.
20.1 The following are excluded from the scope of this section:

(a) leases to explore for or use non-regenerative resources – see Section 34 Specialised activities;
(b) licensing agreements – see Section 18 Intangible assets other than goodwill;
(c) measurement of investment property held by lessees or provided by lessors under operating leases – see Section 16 Investment property;
(d) biological assets held by lessees under finance leases or provided by lessors under operating leases – see Section 34; and
(e) leases that could lead to a loss to the lessor or the lessee as a result of non-typical contractual terms – see paragraphs 12.4(f) and 20.5 of this publication. [FRS102.20.1]

20.2 Agreements between two contracting parties that transfer right of use assets from one party to another are within the scope of this section, regardless of the level of operation and maintenance services to be supplied by the lessor. Some outsourcing and other arrangements (e.g. telecommunication contracts providing rights to capacity) do not take the legal form of a lease but convey rights to use assets in return for payments. [FRS102.20.3]

20.3 The assessment depends on whether:

- fulfilment of the arrangement is dependent on the use of a specific asset(s); and
- the arrangement conveys a right to use the asset, i.e. the right to control the use of the underlying asset. [FRS102.20.3A]

20.4 The asset under the arrangement may be identified explicitly in the arrangement or it may be specified implicitly. For example, a supplier owns or leases only one asset with which to fulfil the arrangement and it is not economically feasible or practical for the supplier to use any alternative assets. [FRS102.20.3A]

20.5 The scope exclusion in paragraph 20.1(e) of this publication is for arrangements that could lead to a loss to the lessor or the lessee as a result of contractual terms that are unrelated to normal lease terms. Normal lease terms include changes in the price of the leased asset, changes in foreign exchange rates and default of one of the counterparties. ‘Changes in the price of the leased asset’ is framed widely and as such this exclusion is expected to be applicable to only a small percentage of lease arrangements with terms that could result in losses unrelated to the leased asset thus making it inappropriate for those arrangements to be accounted for as leases. Such arrangements are accounted for as financial instruments under Section 12 Other financial instruments issues, see paragraph 12.4(f) of this publication. [FRS102.ACA.65-66]

Classification of leases

20.6 A finance lease transfers substantially all the risks and rewards of ownership to the lessee, whereas an operating lease does not. [FRS102.20.4]

20.7 Classification as a finance or operating lease depends on the substance of the transaction rather than the legal form of the lease. A lease would normally be classified as a finance lease in any of the following circumstances:

- ownership of the asset passes to the lessee at the end of the lease term;
- the lessee has an option to purchase the asset at a price that is expected to be less than its fair value, and it is reasonably certain at the beginning of the lease that the option will be exercised;
- the lease is for a majority of the asset’s economic life;
- at the inception of the lease the present value of the minimum lease payments (see paragraph 20.9 of this publication) equates to substantially all of the fair value of the leased asset; or
- the leased assets are specialised in nature such that they could not be used by another lessee without major modification. [FRS102.20.5]
vs EU-IFRS
Applicable standards: IAS 17, SIC 15, SIC 27, IFRIC 4

IFRS20.1 Under IAS 17, operating lease payments that are structured to increase by fixed amounts (even if they reflect expected inflation) are recognised on a straight-line basis. Contingent rents are defined in IAS 17 and are specifically excluded from minimum lease payments.

IFRS20.2 Land and building leases are considered separately to determine the classification of each lease, unless the value of the land at the inception of the lease is deemed immaterial, or it is clear that both elements are either finance leases or operating leases.

IFRS20.3 SIC-27 provides further guidance on evaluating the substance of certain transactions that involve the legal form of a lease.
20.8 The lease term includes the non-cancellable period of the contract and any further periods for which the lessee has an option to continue to lease the asset. The further periods under option are included in the lease term only if, at inception of the lease, it is judged reasonably certain that the lessee will exercise that option. For example, if the lease term is six years but the lessee can cancel the lease without penalty at the end of the third year, then the non-cancellable period of the contract would be three years. However, if at the inception of the lease it is judged reasonably certain that the lessee will not cancel the lease at the end of three years, the lease term would be six years. [FRS102.GL]

20.9 Minimum lease payments are those payments that the lessee is, or can be, required to make to the lessor over the lease term. From the lessee’s point of view, minimum lease payments also include any amount guaranteed by the lessee or a party related to the lessee (e.g. a residual value guarantee). From the lessor’s point of view, minimum lease payments also include residual value guarantees by any third party unrelated to the lessor, provided that that party is financially capable of fulfilling the obligations under the guarantee. [FRS102.GL]

20.10 Other indicators of a finance lease include the lessee being obliged to bear the lessor’s losses on cancellation of the lease, the lessee bearing the residual value risk of the asset, or the lessee having the option of a secondary rental period at a substantially below market rent. [FRS102.20.6]

20.11 The indicators in paragraphs 20.7 and 20.10 of this publication are not always conclusive as to the correct classification of a lease. All features of the lease are considered when determining whether the lease transfers substantially all the risks and rewards incidental to ownership. [FRS102.20.7]

20.12 Classification is determined at the inception of the lease and is not changed unless both parties agree to change the terms of the lease agreement: the lease classification is then reassessed. [FRS102.20.8] The inception of the lease is defined as the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. The commencement of the lease term is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e. the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate). [FRS102.GL]

Financial statements of lessees – finance leases

20.13 At the start of the lease, the lessee recognises a right of use asset and finance lease liability in the balance sheet at the fair value of the leased asset or, if lower, the present value of the minimum lease payments determined at the inception of the lease. Any initial direct costs associated with negotiating and arranging the lease are added to the carrying amount of the asset. [FRS102.20.9]

20.14 The interest rate implicit in the lease is used to calculate the present value of the minimum lease payments (see paragraph 20.9 of this publication) unless this cannot be established. In such cases the incremental borrowing rate (see paragraph 20.15 of this publication) of the lessee is used. [FRS102.20.10] The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments; and

(b) the unguaranteed residual value to be equal to the sum of:

(i) the fair value of the leased asset; and

(ii) any initial direct costs of the lessor. [FRS102.GL]

20.15 The incremental borrowing rate is the interest rate payable by the lessee on a comparable lease or, if that cannot be established, the interest rate the lessee would pay on a loan taken out at the start of the lease, with similar security and for a comparable term. [FRS102.GL]

20.16 After initial recognition, minimum lease payments are apportioned between a finance charge and a reduction in the finance lease liability using the effective interest method (refer to Section 11 Basic financial instruments and paragraphs 11.21 to 11.24 of this publication for further guidance on the effective interest method). The finance charge is allocated such that a constant rate of interest is charged over the lease term on the remaining balance of the liability. As is the case with all leases, contingent rents are expensed as incurred. [FRS102.20.11] Contingent rents are the portion of the lease payments that are not fixed in amount but are based on the future amount of a factor that changes other than with the passage of time (e.g. percentage of future sales, amount of future use, future price indices, and future market rates of interest). [FRS102.GL]
The right of use asset is depreciated in accordance with Section 17 Property, plant and equipment. The asset is depreciated over the shorter of the lease term and the asset’s useful life unless there is reasonable certainty that ownership will pass to the lessee at the end of the lease term. At each reporting date the asset is assessed for impairment in accordance with Section 27 Impairment of assets. [FRS102.20.12]

Financial statements of lessees – operating leases

Operating lease payments (excluding costs for services such as insurance and maintenance) are recognised on a straight-line basis over the lease term. This is the case unless another systematic basis of allocating lease payments is more representative of the asset’s usage pattern or lease payments are structured to increase in line with expected general inflation (i.e. predetermined but based on consensus forecasts or published indices or statistics) to compensate the lessor for expected inflationary costs. Lease payments that are structured to increase in line with actual rates of inflation or are variable in nature, including rentals that vary according to turnover, are recognised as incurred. [FRS102.20.15]

A lessee recognises the aggregate benefit of lease incentives as a reduction to the lease expense recognised in accordance with the paragraph above over the lease term on a straight-line basis, unless another systematic basis is representative of the time pattern of the lessee’s benefit from the use of the leased asset.

Lease incentives are those provided by the lessor to the lessee to enter into or renew an operating lease. Examples of such incentives include up-front cash payments to the lessee, the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, leasehold improvements and costs associated with pre-existing lease commitments of the lessee), or initial periods of the lease provided by the lessor rent-free or at a reduced rent. [FRS102.20.15A, FRS102.GL]

Costs incurred by the lessee (e.g. termination costs of pre-existing leases, relocation costs or leasehold improvements) are accounted for separately from the incentive and in accordance with the relevant section of FRS 102. [FRS102.20.15A]

Section 21 Provisions and contingencies is applicable when operating leases become onerous. [FRS102.20.15B]

Financial statements of lessors - finance leases

The lessor recognises in its balance sheet a finance lease asset equal to its net investment in the lease. This is defined as the lessor’s gross investment in the lease discounted at the interest rate implicit in the lease. The gross investment in the lease is the minimum lease payments receivable plus any unguaranteed residual value accruing to the lessor. [FRS102.20.17] Initial direct costs in negotiating the lease are included in the measurement of the finance lease receivable and reduce income over the lease term. This is not applicable for manufacturer or dealer lessors. [FRS102.20.18]

After initial recognition, finance income is recognised on a basis that reflects a constant periodic rate of return on the net investment in the finance lease. Lease payments reduce the gross investment to reflect both repayment of principal and finance income. If the residual value used in the gross investment calculation changes significantly, the income allocation is revised and any gain or loss is recognised immediately in profit or loss. [FRS102.20.19]

Financial statements of lessors - operating leases

Assets leased under an operating lease are presented in the lessor’s balance sheet in accordance with the requirements of FRS 102 applicable to the relevant type of asset, e.g. investment property (see Chapter 16 of this publication) or property, plant and equipment (see Chapter 17 of this publication). [FRS102.20.24]

Lease income (net of any incentives granted) is recognised on a straight-line basis over the lease term unless another systematic basis of allocating lease payments is more representative of the asset’s consumption, or lease payments are structured such that they increase only in line with general inflation based on published indices or statistics. Lease receipts that are structured to increase in line with inflation or are variable in nature, including leases that vary according to actual rates of inflation or turnover, are recognised as incurred. [FRS102.20.25-25A]

Costs, including depreciation, are expensed as incurred. The depreciation policy for the leased asset is consistent with normal depreciation policy for assets of that type. Any direct costs associated with the negotiation and arrangement of the lease are added to the carrying value of the asset. They are then recognised as an expense over the lease term and on the same basis on which lease income is recognised. [FRS102.20.26]

Section 27 is applied to test a leased asset for impairment. [FRS102.20.28]
Manufacturer or dealer lessors

20.29 Manufacturers or dealers often offer a choice to customers of purchasing or leasing an asset. When an asset is leased under a finance lease this gives rise to both a selling profit or loss (equivalent to an outright sale at normal selling prices) and finance lease income over the lease term. [FRS102.20.20]

20.30 Sales revenue is the fair value of the leased asset or, if lower, the present value of the minimum lease payments calculated at a market rate of interest. Cost of sale is the cost or carrying amount of the asset less the present value of any expected residual value. The difference between revenue and cost, i.e. selling profit or loss, is recognised as profit or loss in line with the lessor’s revenue recognition policy for sales of goods. [FRS102.20.21]

20.31 When an artificially low rate of interest is offered by the lessor, the selling profit is restricted to that achieved using a market rate of interest. Costs of negotiating and arranging the finance lease are expensed when the selling profit is recognised. [FRS102.20.22]

20.32 A manufacturer or dealer leasing an asset under an operating lease does not recognise any selling profit as an operating lease is not the equivalent of a sale. [FRS102.20.29]

Sale and leaseback transactions

20.33 When an asset is sold and then leased back by the seller this constitutes a sale and leaseback transaction. In this case sales price and lease payments are usually interlinked as they will have been negotiated together. [FRS102.20.32]

20.34 When a sale and leaseback transaction results in a finance lease, the seller-lessee does not recognise any income from the sale in excess of the carrying amount of the asset. The excess is deferred and amortised over the lease term. [FRS102.20.33]

20.35 When a sale and leaseback transaction results in an operating lease and the sale is at fair value, the seller-lessee recognises a profit or loss on sale of the asset immediately. If the sales price is less than the fair value the resultant profit or loss is recognised immediately, unless this is compensated by lease payments at lower than market rate. In this case the loss on sale below fair value is deferred and recognised in proportion to the lease payments due over the expected period of use of the asset. If the sales price is greater than the fair value of the asset, the excess is deferred and amortised over the period over which the asset is expected to be used. [FRS102.20.34]
Provisions and contingencies
Overview of requirements

- A provision is a liability of uncertain timing or amount.
- A provision is recognised when an entity has a legal or constructive obligation at a given reporting date as a result of a past event; a transfer of economic benefits in settlement is probable; and the amount of the obligation can be measured reliably.
- Provisions are measured at the best estimate of the amount required to settle the obligation at the reporting date. This is discounted to present value when material.
- Reimbursement (e.g. from insurance) is recognised only when its receipt is virtually certain on settlement of the obligation. Reimbursements are not offset against the provision but shown as separate assets. In the income statement, reimbursements may be shown net of the expense related to the provision.
- Provisions are reviewed at each reporting date and updated to reflect the current best estimate of the liability.
- A contingent liability is either a possible obligation whose existence is yet to be confirmed or a present obligation for which an outflow of resources is not probable, or the amount of the obligation cannot be estimated reliably.
- A contingent liability is not recognised as a liability unless acquired as part of a business combination. Contingent liabilities are disclosed in the financial statements when the possibility of an outflow of resources is not considered remote.
- A contingent asset is a possible asset arising from past events whose existence will be confirmed by the occurrence of a future event not wholly in the entity’s control.
- A contingent asset is not recognised. Disclosure is made when an inflow of economic benefits is considered probable.
vs previous UK GAAP
Applicable standards: FRS 3, FRS 12, UITF 25, UITF 45

pUK21.1 FRS 12 provides more guidance on accounting for restructurings.

pUK21.2 FRS 3 permits the recognition of a provision for loss on disposal of an operation which would not otherwise be permitted under FRS 12 or FRS 102.
21 Provisions and contingencies | 170

FRS 102
Section 21

21.1 This section applies to all provisions and contingencies, except those provisions dealt with elsewhere in FRS 102 (e.g. Section 29 Income tax). Onerous contracts not specifically covered elsewhere in FRS 102 are included in the scope of this section, as are financial guarantee contracts unless the entity has chosen to apply IAS 39 and/or IFRS 9 to its financial instruments or has elected under FRS 103 Insurance contracts (once issued) to continue to apply insurance contract accounting to such contracts. [FRS102.21.1A]

21.2 This section does not apply to:
- financial instruments (including loan commitments) see Section 11 Basic financial instruments and Section 12 Other financial instruments issues;
- reinsurance contracts held by the entity and insurance contracts, reinsurance contracts and financial instruments with a discretionary participation feature issued by the entity that are in the scope of FRS 103. [FRS102.21.1B]

21.3 A discretionary participation feature is a contractual right of the investor or policyholder to receive certain types of additional benefit, as a supplement to guaranteed benefits. Those supplementary benefits are likely to make up a significant portion of the total benefits. The amount and timing is at the discretion of the issuer and based on the performance of specific contract(s), specific investment assets or the entity itself. [FRS102.GL]

21.4 This section applies to executory contracts only if they are onerous.
- Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. [FRS102.21.2]
- An onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. [FRS102.GL] Unavoidable costs are the lower of the costs of completing the contract and any penalties occurring as a result of terminating the contract. [FRS102.21A.2]

Recognition

21.5 A provision is a liability of uncertain timing or amount. [FRS102.GL]

21.6 A provision is recognised when:
- an entity has an obligation as a result of a past event at the reporting date. An obligation can be either a legal or constructive obligation (whereby valid expectations have been raised in other parties as a result of past behaviour);
- it is probable (more likely than not) that an associated transfer of economic benefits will occur; and
- the amount of the obligation can be estimated reliably. [FRS102.21.4]

21.7 Obligations that will arise from the future conduct of the business do not satisfy the above criteria even if they are contractual and no matter how likely they are to occur. [FRS102.21.6]

21.8 For example, the government brings in changes to the income tax system which will result in company A needing to retrain all of its sales staff in order to ensure continued compliance. At the year end the retraining has not yet commenced. The change to the tax system does not represent an obligation for company A to retrain staff and the training itself (the obligating event) has not yet taken place. Company A therefore does not recognise a provision. [FRS102.21A.8]

21.9 Probable future operating losses are not provided for since they do not meet the definition of a liability and there is no past event that obliges the entity to fund the losses (e.g. it could sell the operation). [FRS102.21.11B, FRS102.21A.1]

21.10 A provision for a restructuring is recognised only when the entity has a legal or constructive obligation at the reporting date. A constructive obligation for a restructuring to materially change the scope or manner of business of an entity exists when the entity:
(a) has a detailed formal plan for the restructuring covering the part of the business and locations affected, the approximate number and function of employees at risk of redundancy, the expenditure to be undertaken, and the timescale of the restructuring; and
(b) has raised a valid expectation of the restructuring in those affected either through announcing the major characteristics of the plan or by commencing the restructuring. [FRS102.21.11C,D]
**vs EU-IFRS**

Applicable standards: IAS 37, IFRIC 5, IFRIC 6

IFRS21.1 IAS 37 provides more guidance on accounting for restructurings.
21.11 Onerous contracts (see paragraph 21.4 of this publication) are recognised and measured as a provision. [FRS102.21.11A]

21.12 A provision is recognised as a liability and as an expense unless the cost is required by FRS 102 to be recognised in the cost of an asset. [FRS102.21.5]

**Measurement**

21.13 A provision is measured at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. [FRS102.21.7]

21.14 When the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities. When there is a continuous range of possible outcomes and each point on that range is as likely as any other, the mid-point of the range is used. [FRS102.21.7]

21.15 When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation. However, other possible outcomes are not ignored: when they are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. [FRS102.21.7]

21.16 A provision is discounted to present value when the effect of discounting is material. A pre-tax discount rate is used to perform the discounting that reflects current market assessments of the time value of money. Either the discount rate or the estimated cash flows, but not both, are amended to reflect any risks specific to the liability. [FRS102.21.7]

**Example**

For example, company A sells widgets with a three year warranty. Experience suggests that:

- 80% of widgets require no warranty repairs
- 10% require minor repairs (cost: 20% of sales price)
- 6% require major repairs (cost: 50% of sales price)
- 4% require replacement (cost: 70% of sales price)

Sales in 20X0 are £1m. Warranty costs are therefore estimated at £78k:

\[
\begin{align*}
\text{Sales in 20X0:} & \quad £1m \\
\times 80\% & \quad \times 0 \quad = \quad 0 \\
\times 10\% & \quad \times 20\% \quad = \quad £20k \\
\times 6\% & \quad \times 50\% \quad = \quad £30k \\
\times 4\% & \quad \times 70\% \quad = \quad £28k \\
\text{Total} & \quad = \quad £78k \\
\end{align*}
\]

The estimated timing of these warranty costs is as follows:

- 50% in 20X1
- 30% in 20X2
- 20% in 20X3

Assuming there are no other risks or uncertainties to be reflected, the present value of the expected cash flows for the warranty provision costs is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Expected cash (£k)</th>
<th>Discount rate*</th>
<th>Discount factor</th>
<th>Present value (£k)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>50% x £78k</td>
<td>39</td>
<td>4%</td>
<td>1/(1+0.04) = 0.962</td>
</tr>
<tr>
<td>20X2</td>
<td>30% x £78k</td>
<td>23</td>
<td>5%</td>
<td>1/(1+0.05)^2 = 0.907</td>
</tr>
<tr>
<td>20X3</td>
<td>20% x £78k</td>
<td>16</td>
<td>6%</td>
<td>1/(1+0.06)^3 = 0.840</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Discount rate based on government bonds with the same term as the expected cash flows (4% for 1 year bonds, 5% for 2 year bonds, 6% for 3 year bonds)

Company A therefore recognises a provision for £72k at the end of 20X0 for widgets sold in 20X0. [FRS102.21A.4]
21.18 Any gains from the expected disposal of assets are specifically excluded from the measurement of a provision. [FRS102.21.8]

21.19 If a reimbursement of some or all of the settlement of a provision is expected (e.g. through insurance), the reimbursement is recognised only when it is virtually certain that the reimbursement will be received on settlement of the obligation. The reimbursement asset is not offset against the provision and is presented separately in the balance sheet. The reimbursement amount recognised cannot exceed the amount of the provision. In the income statement, the expense related to the provision may be shown net of any reimbursement income. [FRS102.21.9]

21.20 Only expenditure for which a provision was created is charged against that provision. [FRS102.21.10]

21.21 Provisions are reviewed at each reporting date and updated to reflect the current best estimate of the liability. Changes in the level of provision required are recognised in profit or loss unless recognised originally within the cost of an asset. For provisions discounted to present value, the periodic unwinding of the discount is recognised as a finance cost in profit or loss. [FRS102.21.11]

Contingent liabilities

21.22 A contingent liability is either a possible but uncertain obligation or a present obligation that is not recognised as a liability since it is either not probable that a transfer of economic benefits will occur, or the amount of economic benefit cannot be measured reliably. [FRS102.21.12]

21.23 Contingent liabilities are recognised as liabilities only when they are acquired in a business combination. Contingent liabilities are required to be disclosed unless the possibility of an outflow of resources is remote. When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. [FRS102.21.12]

21.24 For example, company A has been sued by a customer but disputes the claim. Company A’s lawyers advise as at 31 December 20X0 that it is probable that company A will not be found liable. Company A does not therefore have a present obligation as a result of a past obligating event and does not recognise a provision. Assuming the probability of outflow is not deemed remote, the matter is disclosed as a contingent liability in the accounts. [FRS102.21A.9]

Contingent assets

21.25 A contingent asset is a possible asset arising from past events whose existence will be confirmed by the occurrence of a future event not wholly in the entity’s control. [FRS102.21.13]

21.26 Contingent assets are not recognised as assets. Contingent assets are required to be disclosed when an inflow of economic benefits is probable. If an inflow of future economic benefits to the entity becomes virtually certain, the related asset is no longer a contingent asset, and an asset is recognised. [FRS102.21.13]

Disclosures

21.27 Disclosure of contingent liabilities includes a description of the contingency, an estimate of its financial effect, an indication of timing of expected outflow and any reimbursements expected. When it is impracticable to give this disclosure, that fact is stated. [FRS102.21.15]

21.28 Disclosure of contingent assets includes a description and an estimate of the financial effect. When it is impracticable to give this disclosure, that fact is stated. [FRS102.21.16]

21.29 In some extremely rare cases, the disclosures required by this section (including the disclosures required by FRS 102.21.14 for provisions that are not described here) might seriously prejudice the position of the entity in a dispute with other parties. In such cases the disclosure need not be given but instead a general description of the nature of the dispute and the reasons why the necessary disclosure has not been made are given. However, the seriously prejudicial exemption is not available to any UK company in respect of its provisions or contingent liabilities if that disclosure in respect of these items is required by the Companies Act. There would be no similar restriction on availability of the exemption for contingent assets since the Companies Act includes no disclosure requirements for contingent assets. See Schedule 1 paragraph 59 of the Regulations for the Companies Act disclosure requirements. [FRS102.21.17]
Liabilities and equity
Overview of requirements

- Equity is the residual interest in the assets of an entity after deducting all its liabilities.
- A financial instrument is classified as a financial liability if:
  - it contains a contractual obligation to transfer cash or other financial assets; or
  - it will or may be settled in a variable number of the entity’s own equity instruments.
- Some financial instruments meet the definition of a liability but are classified as equity by exception e.g. certain puttable instruments.
- The issue of shares or other equity instruments (including options, rights and warrants) is recognised in equity at fair value of the consideration received, net of issue costs.
- A capitalisation or bonus issue is the issue of new shares to shareholders in proportion to their existing holdings and does not change total equity, though reclassification within equity may be required.
- Proceeds from convertible debt or similar compound financial instruments are allocated first to the liability and then to the equity component.
- The fair value of consideration paid to purchase treasury shares is deducted from equity and no related gain or loss is recognised in profit or loss.
- Distributions to owners are deducted from equity.
- Non-controlling interest (NCI) in the net assets of a subsidiary is presented in equity in the consolidated financial statements.
- Changes in NCI (when the parent does not lose control of the subsidiary) are accounted for in equity. No gain or loss or change in the carrying amounts of assets or liabilities is recognised as a result of such transactions.
pUK22.1 Under previous UK GAAP, after initial recognition of a compound financial instrument, the liability component is always accounted for at amortised cost. The remaining principles in FRS 102 are broadly consistent with FRS 25 but FRS 102 contains less guidance on how to apply these principles.

pUK22.2 Under previous UK GAAP, when a group increases its interest in a non-wholly owned subsidiary, the identifiable assets and liabilities of the subsidiary are revalued to fair value and goodwill is calculated on the increase in interest. When a group decreases its interest in a subsidiary without losing control, any gain or loss on disposal will be recognised in the consolidated profit and loss account.

pUK22.3 Previous UK GAAP does not have a requirement to disclose the fair value of non-cash assets distributed to shareholders.
22 Liabilities and equity

FRS 102
Section 22

22.1 This section of FRS 102 sets out the principles for classification of financial instruments as either equity or liabilities. It discusses the accounting for treasury shares, issued compound financial instruments, equity instruments issued and distributions made to the entity’s owners. This section also deals with the accounting for non-controlling interests in consolidated financial statements. Share-based payment transactions are dealt with in Section 26 Share-based payment. [FRS102.22.1]

22.2 This section is applied to the classification of all financial instruments except employee benefit plans, contingent consideration payable by the acquirer in business combinations, share-based payments (except that treasury shares issued, purchased, sold or cancelled in connection with share-based payments are accounted for under this section), financial guarantee contracts and investments in subsidiaries, associates and joint ventures that are accounted for in accordance with Sections 9, 14 or 15 respectively. Insurance contracts issued, reinsurance contracts issued or held and financial instruments issued with a discretionary participation feature are also not in the scope of this section and entities that issue or hold such contracts apply FRS 103 Insurance contracts (once issued). [FRS102.1.6, FRS102.22.2]

Classification of an instrument as liability or equity

22.3 Equity is the residual interest in the assets of an entity after deducting all its liabilities. Equity includes investments by the owners of the entity, plus or minus retained profits or losses, minus distributions to owners. [FRS102.22.3]

22.4 A financial liability is any liability that is:

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity’s own equity instruments and:

(i) under which the entity is or may be obliged to deliver a variable number of the entity’s own equity instruments; or

(ii) that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity’s own equity instruments. [FRS102.22.3]

22.5 An instrument may contain a contractual obligation to deliver cash or another financial asset depending on the outcome of an uncertain future event that is beyond the control of both the issuer and the holder of the instrument. Examples of such uncertain events are changes in a stock market index, interest rate, taxation requirements and the issuer’s future revenues or debt-to-equity ratio. Since the issuer does not have the unconditional right to avoid making payments, an instrument that contains such contingent settlement provisions is a financial liability unless the part of the contingent settlement provision that could require settlement is not genuine or the issuer can be made to settle in cash or another financial asset only in the event of its own liquidation. [FRS102.22.3A]

22.6 Some financial instruments that meet the definition of a liability are nevertheless classified as equity by exception because they represent the residual interest in the net assets of the entity:

(a) Financial instruments that are automatically redeemed or repurchased by the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder or give the holder the right to ‘put’ them back to the issuer for cash or other financial assets (puttable instruments) meet the definition of a financial liability but are classified as equity by exception if certain conditions are met, including in the event of liquidation. [FRS102.22.4]

(b) Instruments, or components of instruments, that are subordinate to all other classes of instruments are classified as equity if they impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation. [FRS102.22.4]
IFRS22.1 Under EU-IFRS, after initial recognition of a compound financial instrument, the liability component is always accounted for at amortised cost. The remaining principles in FRS 102 are broadly consistent with IAS 32 but FRS 102 contains less guidance on how to apply these principles.

IFRS22.2 IFRIC 17 requires a liability for certain non-cash asset distributions to be recognised, initially and until settlement date, at the fair value of the assets to be distributed. IFRIC 17 also requires any changes in the measurement of the liability to be recognised in equity. At the date on which the distribution occurs (i.e. the settlement date), any difference between the fair value of the assets distributed and their carrying amount in the financial statements is recognised as a separate line item in profit or loss. FRS 102 only requires disclosure of those fair value amounts. It does not require the liability to be recognised at the fair value amount and does not require a profit or loss on distribution to be recognised.

IFRS22.3 EU-IFRS does not provide specific guidance on the treatment of consideration received for new shares before the shares have been issued or vice versa.
22.7 A puttable instrument as described in paragraph 22.6(a) of this publication is classified as an equity instrument subject to the following conditions: if the entity is liquidated, the holder is only entitled to a pro rata share of the entity’s net assets after deducting all other liabilities and the instrument is in a class of instruments with identical features that is subordinate to all other classes of instruments. In addition, apart from the contractual obligation for the issuer to repurchase or redeem the instrument, it does not contain a contractual obligation to deliver or exchange cash or financial assets or liabilities under conditions unfavourable to the entity and it may not be a contract that will or may be settled in the entity’s own equity instruments. Further, the total expected cash flows attributable to the instrument over its life are based on the profit or loss, change in recognised net assets or change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument). [FRS102.22.4]

22.8 In the following examples the instruments would be classified as a liability rather than equity:
(a) when the distribution of net assets on liquidation attributable to the instrument is subject to a cap/maximum amount;
(b) in respect of a puttable instrument, when the put option is exercised, the holder receives an amount that is not calculated based on a pro rata share of the net assets of the entity;
(c) when the entity is obliged to make a payment to the holder before the puttable event or liquidation, for example a mandatory dividend;
(d) preference shares with mandatory redemption at a fixed or determinable amount at a fixed or determinable date in the future, or when the holder has the right to require such redemption;
(e) a puttable instrument issued by a subsidiary and classified as equity in the subsidiary financial statements is treated as a liability in the consolidated financial statements.

22.9 Members’ shares in co-operative entities and similar instruments are equity when the entity has an unconditional right to refuse redemption of the members’ shares, or redemption is unconditionally prohibited by local law, regulation or the entity’s governing charter. [FRS102.22.6]

Issue of shares or other equity instruments
22.10 The issue of shares or other equity instruments is recognised when the instruments are issued and another party is obliged to provide cash or resources in exchange for those instruments. If cash or resources are received by the entity before the issuance of equity instruments, the consideration received and a corresponding increase in equity are recognised in the financial statements provided the entity cannot be obliged to repay the consideration. When equity instruments have been subscribed for but not yet issued, there is no change to equity unless the cash or other resources have been received. [FRS102.22.7]

22.11 Equity instruments are measured at the fair value of the cash or resources received net of direct costs of issuing the instrument. The amount is discounted to present value if the payments are deferred and the effect of discounting is material. [FRS102.22.8] Equity transaction costs are treated as a deduction from equity, net of any related income tax benefit. [FRS102.22.9]

22.12 The presentation of individual components of equity is a matter of applicable local law; for example, separate presentation of share capital and share premium is required in the UK under the Companies Act. [FRS102.22.10]

22.13 Equity issued by means of exercise of options, rights, warrants or other similar instruments is accounted for in the same way as the issue of shares as discussed in paragraphs 22.10 to 22.12 of this publication. [FRS102.22.11]

Capitalisation or bonus issues of shares and share splits
22.14 A bonus issue or capitalisation is the issue of new shares to existing shareholders in proportion to their existing holdings. A share split is the dividing of an entity’s existing shares into multiple shares. Bonus issues and share splits do not change total equity but may require a reclassification within equity depending on applicable legal requirements. Under UK legislation, a bonus issue may be out of retained earnings or share premium. [FRS102.22.12]
Convertible debt or similar compound financial instruments

22.15 Convertible debt or similar compound instruments may contain both a liability and equity component. The proceeds are allocated between the debt and equity components. To determine the allocation, first the fair value of the liability component is determined by comparison to a similar liability with no equity component or conversion feature. The residual proceeds are allocated to the equity component of the instrument. Transaction costs are split between the debt and equity components in a manner consistent with the allocation of the proceeds. [FRS102.22.13] The liability and equity split of the instrument is not subsequently revised after initial recognition. [FRS102.22.14]

22.16 After initial recognition the liability component is accounted for either as a ‘basic financial instrument’ in accordance with Section 11 or as an ‘other financial instrument’ in accordance with Section 12, as appropriate. The appendix to Section 22 Example of the issuer’s accounting for convertible debt illustrates the accounting treatment when the liability component is a ‘basic financial instrument’ under Section 11. [FRS102.22.15]

Treasury shares

22.17 The term ‘treasury shares’ refers to issued equity instruments of an entity that have subsequently been reacquired by that entity or other members of the consolidated group. [FRS102.GL] This definition is different from the Companies Act definition (section 724) which uses the term ‘treasury shares’ only for shares reacquired directly by the issuing entity.

22.18 The fair value of consideration paid to acquire treasury shares is deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, transfer or cancellation of treasury shares. [FRS102.22.16]

22.19 Under UK law, if the proceeds of sale of a treasury share held directly by the issuing entity exceed the price paid by the entity the excess is recognised as additional share premium. This requirement to recognise additional share premium does not apply to treasury shares held indirectly, e.g. through an entity’s employee benefit trust. If a subsidiary or employee benefit trust acquires a parent equity instrument this is not a treasury share in the financial statements of the subsidiary or employee benefit trust.

22.20 For the consolidation requirements regarding employee benefit trusts, see also paragraphs 9.18 to 9.24 of this publication.

Distributions to owners

22.21 Distributions to owners are deducted from equity. [FRS102.22.17] If assets other than cash are distributed, the fair value of the assets distributed is disclosed unless the ultimate control of the assets is unchanged. [FRS102.22.18]

Non-controlling interest and transactions in shares of a consolidated subsidiary

22.22 In consolidated financial statements, a non-controlling interest in the net assets of a subsidiary is included in equity. Changes in a parent’s ownership interest in a subsidiary that do not result in the loss of control are accounted for as equity transactions and no gain or loss is recognised. In addition, the subsidiary’s net assets (including goodwill) included in the consolidated financial statements are not adjusted as a result of such transactions. The only adjustment relates to the carrying amount of the non-controlling interest which is updated for the change in the parent’s interest in the subsidiary’s net assets. Any resulting difference between the remeasurement of non-controlling interest and the fair value of the consideration paid or received is recognised directly in equity. See paragraphs 9.28 to 9.33 and 19.23 to 19.25 of this publication. [FRS102.22.19]
Overview of requirements

• This section applies to revenue arising from the sale of goods, rendering of services, construction contracts and the use by others of assets generating interest, royalties or dividends.

• Revenue is measured at the fair value of the consideration received or receivable. This takes into account trade discounts, early settlement discounts and volume rebates.

• Revenue excludes amounts collected on behalf of third parties (such as sales taxes).

• When cash payments are deferred and constitute an element of financing, the fair value of consideration is the present value of all future receipts.

• Revenue is not recognised from transactions in which similar goods or services are exchanged or transactions which lack commercial substance.

• Revenue from the sale of goods is recognised when the significant risks and rewards of ownership are transferred, continuing managerial involvement is not indicative of control or ownership, the amount of revenue and the related costs can be measured reliably and it is probable that the benefits of the transaction will be received by the entity.

• Revenue associated with the rendering of services is measured based on the percentage of completion of the transaction when the amount of revenue, costs and stage of completion can be measured reliably and it is probable that the benefits of the transaction will be received by the entity.

• If the outcome of a construction contract can be measured reliably, revenue is recognised according to the stage of completion.

• Interest income is recognised using the effective interest method.

• Royalty income is recognised on an accruals basis.

• Dividend income is recognised when the right to receive payment has been established.
pUK23.1 When a contractual arrangement covers the provision of a number of different goods or services, FRS 5 provides more detailed guidance than FRS 102 for determining whether such ‘components’ are accounted for together or separately.

pUK23.2 FRS 5 includes specific guidance on various other revenue recognition matters, including determining whether an entity is principal or agent. FRS 5 requires that subsequent changes in estimates of a liability for outstanding loyalty awards in a customer loyalty programme (known as voucher accounting in FRS 5) are recognised in revenue.

pUK23.3 The scope of SSAP 9 may differ from that of FRS 102. SSAP 9 deals with long-term contracts, which are contracts for either the construction of an asset or the provision of services when the contract activity falls into different accounting periods such that not recognising turnover and attributable profit on contracts in progress would distort the true and fair view. Some arrangements meeting the definition of a long-term contract in SSAP 9 may not meet the definition of a construction contract within FRS 102.
23.1 This section applies to revenue arising from the sale of goods, rendering of services, construction contracts and the use by others of the entity’s assets to generate for it interest, royalties or dividends. Revenue or other income arising from the following sources is covered elsewhere in FRS 102:

- lease agreements – see Section 20 Leases;
- income such as dividends from equity accounted investments – see Section 14 Investments in associates and Section 15 Investments in joint ventures;
- fair value movements and disposal of financial assets and liabilities – see Section 12 Other financial instruments issues;
- movements in fair value of investment property – see Section 16 Investment property;
- movements in fair value and recognition of biological assets and agricultural produce – see Section 34 Specialised activities; [FRS102.23.2] and
- revenue or other income arising from transactions and events dealt with in FRS 103 Insurance contracts (once issued). [FRS102.23.2A]

Measurement

23.2 Revenue is measured at the fair value of consideration received or receivable. This includes any trade discounts, prompt settlement discounts or volume rebates offered. [FRS102.23.3]

23.3 Amounts collected on behalf of third parties, such as sales taxes, goods and services taxes and value added taxes, are not classified as revenue. In an agency relationship, only the amount of commission is recognised as revenue by the agent. [FRS102.23.4]

23.4 When the transaction includes an element of financing via deferred payment terms, revenue is measured at the present value of future receipts. These receipts are discounted at the more clearly determinable of the rate for a similar instrument issued by an entity with a similar credit rating and the rate which discounts the future cash receipts to the current cash price of the goods or services. The difference between the fair value and the nominal value of future receipts is recognised as interest in accordance with paragraph 23.28 of this publication and Section 11 Basic financial instruments. [FRS102.23.5]

Exchanges of goods or services

23.5 Revenue is not recognised when the transaction is an exchange of goods or services that are of a similar nature and value or when the transaction lacks commercial substance. [FRS102.23.6]

23.6 Revenue is recognised when the transaction is an exchange of goods or services for dissimilar goods or services and the transaction has commercial substance. When the fair value of the goods or services received can be measured reliably, revenue is measured at that fair value adjusted for any cash or cash equivalents transferred to or from the entity. If this fair value cannot be measured reliably, then revenue is measured based on the fair value of the goods or services given up (again adjusted for cash or cash equivalents). If neither fair value can be measured reliably, the carrying amount of the assets given up (adjusted for cash or cash equivalents) is used to measure revenue. [FRS102.23.7]

Identification of the revenue transaction

23.7 If necessary to reflect the substance of the transaction, the revenue recognition criteria are applied separately to separately identifiable components of a single transaction, for example when the selling price of a product includes an identifiable amount for subsequent servicing. [FRS102.23.8]

23.8 Similarly, when two or more transactions are linked such that the commercial effect cannot be understood without considering all related transactions, the recognition criteria are applied to those transactions together. For example, the recognition criteria are applied to two transactions together when an entity sells and at the same time agrees to repurchase goods at a later date. [FRS102.23.8]
| IFRS23.1 | IAS 18 has a similar scope to FRS 102. However, revenue arising from the extraction of mineral ores and changes in the value of current assets are excluded from the scope of IAS 18. |
| IFRS23.2 | IFRIC 13 provides additional guidance on customer loyalty programmes. This includes the required accounting when a third party issues awards and the recognition of onerous awards. |
| IFRS23.3 | IFRIC 15 provides more detailed guidance on the accounting for the construction of real estate. These arrangements are accounted for under either IAS 11 or IAS 18, primarily depending on when control of the constructed asset passes to the customer. IFRIC 15 introduces the concept of continuous transfer. The continuous transfer method is not included in FRS 102. |
23.9 Customer loyalty schemes, in which the customer is granted an award that it may redeem in the future for free or discounted goods or services, are accounted for as a separately identifiable component of the initial sales transaction. The fair value of the consideration received or receivable in respect of the initial sale is allocated between the loyalty award and the other components of the sale. The consideration apportioned to the loyalty award is measured by reference to the fair value of the award credits, i.e. the amount for which they could be sold separately. [FRS102.23.9]

Sale of goods

23.10 Revenue from the sale of goods is recognised when:
- the significant risks and rewards of ownership of the goods have been transferred to the buyer;
- the seller does not retain a level of continuing managerial involvement usually associated with ownership or effective control over the goods sold;
- the amount of revenue and costs incurred or to be incurred in respect of the transaction can each be measured reliably; and
- it is probable that economic benefits will flow to the entity as a result of the transaction. [FRS102.23.10]

23.11 This assessment requires an examination of the circumstances of the transaction. In most cases the risks and rewards of ownership pass when legal title or possession transfers to the buyer. This would apply to most retail sales. Examples of situations when the seller retains the significant risks and rewards include:
- when the seller retains an obligation for unsatisfactory performance beyond that covered by a normal warranty arrangement;
- when the receipt of revenue is contingent on the buyer selling the goods to a third party;
- when goods are shipped subject to installation and that installation, which is a significant part of the contract, is not yet complete; and
- when the buyer has a right to return the goods, either for reasons specified in the sales contract or at the buyer’s discretion, and the seller is not certain about the probability of return. [FRS102.23.11-12]

23.12 If only an insignificant risk of ownership is retained by the seller, revenue is recognised. This is the case when legal title is retained solely to protect the collectability of the amount due or when a refund is offered for faulty goods and the probability of such returns can be estimated reliably. [FRS102.23.13]

Rendering of services

23.13 When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue is recognised using the percentage of completion method. The outcome can be estimated reliably when the revenue, costs incurred and costs to complete the transaction can be measured reliably, it is probable that economic benefits will flow to the entity and the stage of completion at the reporting date can be measured reliably. [FRS102.23.14]

23.14 When the services performed are an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis unless another revenue recognition method better represents the stage of completion. If one specific act within the contract is much more significant than any other act, recognition of revenue is postponed until that act has been performed. [FRS102.23.15]

23.15 If the outcome of the transaction cannot be estimated reliably, revenue is recognised only to the extent of the expenses recognised that are recoverable. [FRS102.23.16]

Construction contracts

23.16 A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of design, technology and function or their ultimate purpose or use. [FRS102.GL]

23.17 Contract revenue and contract costs associated with a construction contract are recognised as revenue and expenses respectively by reference to the stage of completion of the contract when the outcome of the contract can be estimated reliably (the percentage of completion method). The outcome can be estimated reliably when the stage of completion, future costs and collectability of billings can be estimated reliably. [FRS102.23.17]

23.18 In some circumstances it may be necessary to treat identifiable components of a single contract separately or to consider a group of contracts together in order to reflect the substance of a contract or a group of contracts. [FRS102.23.18]
23.19 Some construction contracts cover the construction of a number of assets. The construction of each asset is treated as a separate contract when separate plans subject to separate negotiation are submitted for each asset, the contractor and customer may accept or reject parts of the contract relating to each asset and the costs and revenues of each asset can be separately identified. [FRS102.23.19]

23.20 A group of contracts is treated as a single construction contract, whether with a single customer or with several customers, when the contracts are negotiated as a single arrangement that is in effect a single project with an overall profit margin and the contracts are performed concurrently or in a continuous sequence. [FRS102.23.20]

**Percentage of completion method**

23.21 Revenue from rendering services and from construction contracts is recognised using the stage or percentage of completion method. The estimates of revenue and costs are reviewed and, when necessary, revised as the arrangement progresses. [FRS102.23.21]

23.22 Stage of completion of a transaction or contract is determined using the method that measures the work performed most reliably. Progress payments and advances received from customers are often not representative of the work performed. Techniques to measure the stage of completion include:

(a) the costs incurred for work performed to date as a proportion of the estimated total costs. Costs incurred for work performed to date do not include costs relating to future activity, such as for materials or prepayments;

(b) surveys of work completed;

(c) completion of a physical proportion of the contract work or the completion of a proportion of the service contract. [FRS102.23.22]

23.23 Prepayments or other costs that relate to future activity, such as materials, are recognised as an asset when it is probable that those costs will be recovered. [FRS102.23.23] Costs whose recovery is not probable are recognised immediately as an expense. [FRS102.23.24]

23.24 If the outcome of a construction contract cannot be estimated reliably:

(a) revenue is recognised only to the extent of contract costs incurred, when it is probable that those amounts will be recoverable; and

(b) contract costs are recognised as an expense in the period in which they are incurred. [FRS102.23.25]

23.25 Expected losses (when it becomes probable that contract costs will exceed contract revenue) are recognised as an expense in profit or loss immediately. A corresponding onerous contract provision is recognised. [FRS102.23.26]

23.26 When the collectability of an amount already recognised as revenue is no longer probable, this is recognised as an expense. Contract revenue is not adjusted. [FRS102.23.27]

**Interest, royalties and dividends**

23.27 Revenue arising from the use of an entity’s assets by others, yielding interest, royalties or dividends for the entity, is recognised when it is probable that economic benefits associated with the transaction will flow to the entity and the amount can be measured reliably. [FRS102.23.28]

23.28 Interest income is recognised using the effective interest method as described in paragraph 11.21 of this publication. Royalties are recognised on an accruals basis in accordance with the substance of the relevant agreement. Dividends are recognised when the entity’s right, as shareholder, to receive payment is established. [FRS102.23.29]

**Further guidance**

23.29 The appendix to Section 23 *Examples of revenue recognition under the principles in Section 23* provides further examples on the application of these requirements.
Government grants
Overview of requirements

• Deals with all government grants.

• Normal trading transactions and assistance that cannot reasonably have a value placed on them are not government grants. Government assistance provided through adjustment to income taxes are accounted for as part of those taxes (see Section 29 Income tax).

• The choice of performance or accrual model is made on a class-by-class basis.

• In the performance model the grant is recognised when its performance conditions are met.

• In the accrual model revenue grants are recognised in income over the same period as the related costs; asset-related grants are recognised in income over the life of the asset.
**Cutting through UK GAAP**

Applicable standard: SSAP 4

pUK24.1 Government grants are not recognised in profit or loss until the conditions attached to the grant are met and there is reasonable assurance that the grant will be received. While the FRS 102 performance model contains a similar restriction, the accrual model has only the general recognition restriction of there being reasonable assurance that the conditions will be met.

pUK24.2 SSAP 4 allows non-Companies Act entities to offset grants against the cost of the related asset.

**vs EU-IFRS**

Applicable standards: IAS 20, IAS 41, SIC 10

IFRS24.1 IAS 20 requires that government grants are not recognised in profit or loss until the conditions attached to the grant are met and there is reasonable assurance that the grant will be received. This restriction is included in the FRS 102 performance model but not the accrual model.

IFRS24.2 IAS 41 deals with grants relating to biological assets recognised at fair value less costs to sell, including those requiring the entity not to engage in specified agricultural activity. These grants are recognised only when they become receivable. This may be in a different period from that in which the related costs are incurred. These grants are not deducted against the carrying amount of the biological asset.

IFRS24.3 IAS 20 allows grants of non-monetary assets to be recognised at the fair value of the non-monetary assets or at a nominal amount. Non-monetary grants are within the scope of Section 24 Government grants, and are accounted for at fair value.

IFRS24.4 IAS 20 allows grants relating to assets to be presented as deferred income or as a deduction from the carrying amount of the asset.

IFRS24.5 IAS 20 includes additional guidance on accounting for forgivable loans and below market rate loans from the government.
Scope

24.1 This section deals with all grants by government. Government grants are transfers of resources to an entity by a local, national or international government entity in return for compliance with certain past or future conditions related to the operating activities of the entity receiving the grant. [FRS102.24.1, FRS102.GL]

24.2 This section does not cover government assistance that cannot be valued or be differentiated from the entity’s normal trading activity. Neither does it cover benefits that are available through the determination of taxable profit or calculated by reference to the entity’s tax liability, such as income tax holidays, investment tax credits, capital allowances and reduced income tax rates (see Section 29 Income tax). Non-exchange transactions (i.e. donations of cash, goods or services) are covered in Chapter 34I of this publication. [FRS102.24.3]

Recognition and measurement

24.3 Grants are recognised only when there is reasonable assurance that the conditions attached to the grant will be met and the grant will be received. Grants are measured at the fair value of the asset receivable. A liability is recognised when a grant becomes repayable and meets the definition of a liability. [FRS102.24.3A,5,5A]

24.4 Grants are recognised using either the performance model or the accrual model. The same policy is applied consistently to a class of grant. [FRS102.24.4]

Performance model

24.5 A grant with no future performance-related conditions is recognised in income when it is received or receivable. [FRS102.24.5B(a)]

24.6 A grant that imposes future performance-related conditions on the recipient is recognised in income when these conditions are met. [FRS102.24.5B(b)]

24.7 Grants received before the recognition criteria are met are recognised as a liability. [FRS102.24.5B(c)]

Accrual model

24.8 Under the accrual model a grant is classified as relating either to revenue or to assets. [FRS102.24.5C]

24.9 Revenue grants are recognised in income on a systematic basis over the same period as the related costs. [FRS102.24.5D] When those costs have already been incurred, the grant is recognised in income when it is receivable. [FRS102.24.5E]

24.10 Asset grants are recognised in income on a systematic basis over the life of the related asset. [FRS102.24.5F] Grants relating to assets are recognised as deferred income. They are not deducted from the carrying value of the asset. [FRS102.24.5G]
Borrowing costs
Overview of requirements

- Borrowing costs may either be capitalised or expensed in profit or loss in the period in which they are incurred. The policy choice is applied consistently to a class of qualifying assets.
**vs previous UK GAAP**

Applicable standard: FRS 15

pUK25.1 Previous UK GAAP addresses capitalisation of borrowing costs only for tangible fixed assets. If the entity adopts an accounting policy of capitalising borrowing costs, then directly attributable finance costs are included in the asset’s cost. The scope of FRS 102 is wider, including, for example, inventories that take a substantial period of time to get ready for sale.

**vs EU-IFRS**

Applicable standard: IAS 23

IFRS25.1 Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are required to be capitalised as part of the cost of that asset. There is no option to expense such costs.
25 Borrowing costs

FRS 102
Section 25

25.1 Borrowing costs are interest and other costs that are incurred in connection with the borrowing of funds. Borrowing costs include:
(a) interest expense calculated using the effective interest method as described in Section 11 Basic financial instruments;
(b) finance charges in respect of finance leases recognised in accordance with Section 20 Leases; and
(c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. [FRS102.25.1]

Recognition

25.2 There is an accounting policy choice between capitalising borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets into the cost of the asset, or expensing them in profit or loss as incurred. The adopted policy is applied consistently to a class of qualifying assets. [FRS102.25.2]

25.3 Directly attributable borrowing costs are those that would have been avoided if the qualifying asset had not been acquired, constructed or produced. [FRS102.25.2A]

25.4 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale, e.g. inventories, manufacturing plants, power generation facilities, intangible assets and investment properties may be qualifying assets. Financial assets, and inventories that are produced over a short period of time, are not qualifying assets. [FRS102.GL]

25.5 The amount of borrowing costs eligible to be capitalised is determined as follows:
(a) if the funds are borrowed specifically to fund the qualifying asset, actual borrowing costs incurred less any investment income on any temporary investment of the borrowing; [FRS102.25.2B]
(b) if the funds used to obtain the asset form part of the entity’s general borrowings, a capitalisation rate is applied to the expenditure on the qualifying asset. [FRS102.25.2C]

25.6 The capitalisation rate is the weighted average borrowing rate for those borrowings outstanding in the period, excluding any borrowings specific to any qualifying assets. [FRS102.25.2C]

25.7 The expenditure on which interest is capitalised is the average carrying amount of the qualifying asset during the period, including previously capitalised borrowing costs. The amount of borrowing costs capitalised in a period cannot exceed the actual borrowing costs incurred in that period. [FRS102.25.2C]

25.8 Capitalisation of borrowing costs commences when all of expenditure, borrowing costs and activity on the asset are occurring. It ceases when substantially all the activities to prepare the asset for use or sale are complete. Capitalisation is suspended when active development has paused for an extended period. [FRS102.25.2D]
Share-based payments
Overview of requirements

• In an equity-settled share-based payment the entity either receives goods or services as consideration for its own equity instruments or receives goods or services but has no obligation to settle the transaction.

• In a cash-settled share-based payment a liability, based on the price or value of equity instruments of the entity or another group entity, is incurred in exchange for goods or services received.

• When goods are obtained or services received there is a corresponding increase in equity, for equity-settled share-based payments, or a liability, for cash-settled share-based payments.

• If a share-based payment to an employee vests immediately there is an immediate increase in equity or liabilities. If the share-based payment does not vest until the employee has completed a specified period of service there is a corresponding increase in equity or liabilities as those services are received.

• Share-based payments may be subject to the achievement of vesting conditions. These are usually related to service or performance.

• Equity-settled share-based payments are measured at the fair value of the goods or services received when this can be estimated reliably.

• The fair value of a modification that is beneficial to the employee is accounted for over the modified vesting period; other modifications are ignored.

• Cancellations or settlement of equity-settled share-based payments are treated as an acceleration of vesting; any remaining charge is recognised immediately.

• Cash-settled share-based payment transactions are measured at the fair value of the liability incurred. This liability is remeasured until the award is settled. Movements are recognised in profit or loss.

• A share-based payment transaction with a choice of settlement is treated as a cash-settled share-based payment unless either there is a past practice of settling by issuing equity instruments or there is no commercial substance to the cash settlement offer.

• Members of a group share-based payment plan can recognise and measure their share-based payment expense based on a reasonable allocation of the share-based payment expense of the group.
The requirements of FRS 20 are identical to those of IFRS 2, see the 'vs EU-IFRS' section.
Section 26

26.1 This section covers both equity-settled and cash-settled share-based payment transactions and transactions when either party has a choice of either equity or cash settlement. [FRS102.26.1]

26.2 In an equity-settled share-based payment transaction, goods or services are received as consideration for equity instruments (e.g. shares or share options) or are received but the entity has no obligation to settle the transaction. [FRS102.26.1(a)]

26.3 In a cash-settled share-based payment transaction goods and services are acquired by incurring a liability that is based on the price or value of equity instruments of the entity or of another group entity. [FRS102.26.1(b)] Cash-settled share-based payments include share appreciation rights (an entitlement to a future cash payment based on the increase in the entity’s or another group entity’s share price over a specified period of time) and arrangements when employees are granted a right to equity instruments that are redeemable, either mandatorily (e.g. upon cessation of employment) or at the employee’s option. [FRS102.26.2]

26.4 A share-based payment transaction may be settled by another entity or shareholder within the group on behalf of the entity receiving the goods or services. The requirements of this section apply to such transactions unless the transaction is clearly unrelated to the goods or services received. [FRS102.26.1A]

Recognition

26.5 The goods or services acquired in a share-based payment transaction are recognised when the entity obtains the goods or as the services are received. A corresponding increase in equity for an equity-settled share-based payment transaction, or a liability for a cash-settled share-based payment transaction, is recognised. [FRS102.26.3] The amounts recognised in a share-based payment transaction are recognised as assets when they meet the recognition requirements of another section of FRS 102, such as Section 13 Inventories or Section 18 Intangible assets other than goodwill, or are expensed. [FRS102.26.4] However, remeasurement of a cash-settled share-based payment liability is recognised in profit or loss. [FRS102.26.14]

26.6 When an employee is unconditionally entitled to a share-based payment without completing a period of service, the share-based payment vests immediately. The services received from the employee are recognised in full on the grant date and equity or liabilities are increased accordingly. [FRS102.26.5]

26.7 If there is a required period of service between the grant date and vesting date of a share-based payment granted to an employee, it is presumed that the services to be received in consideration for the payment will be received in the future over the vesting period. [FRS102.26.6]

Measurement of equity-settled share-based payment transactions

26.8 Equity-settled share-based payments are measured at the fair value of the goods or services received. If this cannot be estimated reliably, the fair value of the equity instruments granted is used instead. In transactions with employees it is not usually possible to estimate reliably the fair value of the services received. [FRS102.26.7]

26.9 For transactions with employees fair value is measured at grant date. For transactions with other parties fair value is measured when services are rendered or goods received. [FRS102.26.8]

26.10 In some cases receipt of the share-based payment is conditional on certain vesting conditions being met. Vesting conditions may be related to performance or service. Vesting conditions include staying in employment for a specified period of time (a service condition), the entity achieving a specified growth in profit (a non-market condition) or a specified increase in share price (a market condition). A market condition is one related to the market price of the relevant equity instrument, for example a specified share price being reached or the relative levels of the entity’s equity instruments and an index of equity market prices. There may also be non-vesting conditions (e.g. the employee making regular contributions to a plan or the movement of a commodity index). [FRS102.26.9, FRS102.GL]

26.11 Vesting conditions relating to service or non-market performance are considered when estimating how many equity instruments will vest. That estimate is subsequently revised if conditions and expectations change. On the vesting date the estimate is revised to reflect the actual number of equity instruments that vested. Market vesting conditions and non-vesting conditions are taken into account only when estimating the fair value of the equity instruments awarded at grant date. These estimates are not subsequently adjusted, regardless of the outcome of the market or non-vesting condition. [FRS102.26.9]
vs EU-IFRS
Applicable standard: IFRS 2

Scope

IFRS26.1 IFRS 2 specifically excludes from its scope the following arrangements that would otherwise meet the definition of a share-based payment arrangement:

- transactions with employees in their capacity as owners (for example a rights issue);
- equity instruments issued in a business combination in exchange for control of the acquiree; and
- contracts within the scope of IAS 32.8-10 or IAS 39.5-7.

Measurement

IFRS26.2 The fair value of equity instruments is determined based on market prices, taking into account all the terms and conditions of the award. When market prices are not available, fair value is determined using a valuation technique. IFRS 2 does not include a three-tier measurement hierarchy. In rare cases when the fair value of the equity instruments granted cannot be measured reliably at the measurement date, IFRS 2 allows the use of the intrinsic value of the equity instruments.

Share-based payment transactions with cash alternatives

IFRS26.3 Under IFRS 2, when the entity has the choice of settling a share-based payment in cash or equity instruments it classifies the arrangement as equity-settled unless the choice of settlement in equity instruments has no commercial substance or if the entity has a past practice or stated policy of settling in cash. If the counterparty has the choice of settlement, then the entity has granted a compound instrument that includes a liability component and an equity component. These are accounted for separately. Under FRS 102, when either the entity or the counterparty has a choice of settlement the arrangement is classified as cash-settled unless the entity has a past practice of settling by issuing equity instruments or the choice of settlement in cash has no commercial substance.

Cancellations and settlements

IFRS26.4 If the entity or counterparty can choose whether a non-vesting condition is met, then any failure to meet that condition is accounted for as a cancellation. If vested equity instruments are repurchased by an entity, then the payment made to the employee is deducted from equity except to the extent the payment exceeds the fair value of the equity instruments repurchased at the repurchase date. Any excess over fair value is recognised as an expense.

IFRS26.5 If, on cancellation, new equity instruments are granted to the employee and identified as a replacement of the cancelled share-based payment, then this is accounted for as a modification of the original share-based payment.

Group plans

IFRS26.6 For group plans, IFRS 2 does not allow allocation of an expense between members of a group plan on the basis of a reasonable allocation of the group’s expense. IFRS 2 does not include any exemption from its recognition and measurement requirements in respect of group plans.
**Fair value of shares, share options and equity-settled share appreciation rights**

26.12 A three-tier measurement hierarchy is used to measure the fair value of shares, share options and equity-settled share appreciation rights: [FRS102.26.10]

- **Is an observable market price available for the instruments?**
  - Yes → Use observable market price.
  - No → **Is entity-specific observable market data available?**
    - Yes → Use entity-specific observable market data.
    - No → If entity-specific data is unavailable or impractical to obtain, fair value is measured using a method which is consistent with generally accepted valuation methodologies that use market data to the greatest extent.

**Modifications to the terms and conditions on which equity instruments were granted**

26.13 Modifications change the terms of the share-based payment arrangement. If a modification is beneficial to the recipient, for example by changing the vesting conditions in a way that is beneficial to the employees by increasing the option’s fair value, the incremental fair value is included in the amount recognised for services received. The incremental fair value is the difference between the modified and unmodified arrangements, both measured at the modification date. If the modification occurs during the vesting period, the incremental fair value is spread over the period from the modification date to the modified vesting date. The original fair value continues to be recognised on the same basis as before modification. [FRS102.26.12(a)]

26.14 Modifications that are not beneficial to the employee are ignored. The entity continues to account for the services received under the original award as if the modification had not occurred. [FRS102.26.12(b)]

**Cancellations and settlements**

26.15 A cancellation or settlement of an equity-settled share-based payment award is accounted for as an acceleration of vesting. The amount that would otherwise have been recognised for services received over the remaining vesting period is recognised immediately. [FRS102.26.13]

**Cash-settled share-based payment transactions**

26.16 In a cash-settled share-based payment transaction, the fair value of the liability is used to measure the goods and services received and liability incurred. The liability is remeasured at fair value at each reporting date and at the settlement date. Changes in fair value are recognised in profit or loss for the period. [FRS102.26.14]

**Notes:**

1 Instruments include shares, share options or equity-settled share appreciation rights.
2 For example a recent sale transaction or recent independent valuation of the entity’s assets.
3 This may often be the case particularly for options. The directors use their judgement to apply appropriate valuation methodology. For options and share appreciation rights, an option pricing model is normally used. Inputs include weighted average share price, exercise price, option life, expected dividends, expected volatility and the risk-free interest rate. Estimates of expected volatility are determined in a manner consistent with the technique used to determine the share price.
Share-based payment transactions with cash alternatives

26.17 When the entity or counterparty has a choice of settlement in cash or equity instruments, the share-based payment is accounted for as a cash-settled arrangement, with two exceptions. If the entity has a past practice of settling in equity instruments or the choice of settlement does not have commercial substance (e.g. when the amount of cash settlement offered is not related to, and is likely to be lower than, the fair value of the equity instrument) the transaction is accounted for as equity-settled. [FRS102.26.15]

Group plans

26.18 When an entity grants a share-based payment to employees of other entities in the group, those entities can either measure their share-based payment expense based on a reasonable allocation of the expense for the group or follow the treatment in paragraphs 26.5 to 26.17 of this publication. [FRS102.26.16]

Government-mandated plans

26.19 In some jurisdictions local law requires that equity investors (which may include employees) are able to acquire equity instruments by providing either no goods or services that are specifically identifiable or ones that are clearly less valuable than the fair value of the equity instruments granted. This indicates that other consideration (such as past or future employee services) has or will be provided to the entity. These transactions are equity-settled share-based payments. The unidentifiable goods or services received (or to be received) are measured as the difference between the fair value of the share-based payment and of any identifiable goods or services measured at the grant date. [FRS102.26.17]

Disclosure exemption

26.20 Qualifying entities applying FRS 102 are exempt in their individual financial statements from certain disclosure requirements. See paragraph 3.7 of this publication.
Impairment of assets
Overview of requirements

- Section 27 Impairment of assets applies to the impairment of assets other than those considered by other sections of FRS 102, e.g. deferred tax assets.

- An impairment test is carried out for inventory at each reporting date. An impairment loss is recognised in profit or loss when the inventory’s selling price less costs to complete and sell is lower than its carrying amount at the reporting date.

- For assets other than inventory, the existence of indicators of impairment is assessed at each balance sheet date. An impairment test is carried out only when an impairment indicator exists.

- An asset’s recoverable amount is the higher of its value in use and fair value less costs to sell.

- Impairments of revalued assets are treated as revaluation decreases to the extent that they reverse a revaluation increase, with any remainder recognised in profit or loss.

- Impairment testing is carried out at the asset or cash-generating unit (CGU) level, depending on whether an estimate of recoverable amount can be made at the asset level.

- An impairment loss recognised for a CGU is allocated first to goodwill within the CGU and then pro rata to other assets based on their carrying amounts.

- For the purpose of impairment testing, the carrying amount of a CGU is grossed up to include goodwill attributable to any non-controlling interests.

- If goodwill cannot be allocated to individual CGUs or groups of CGUs on a non-arbitrary basis, it is tested for impairment by determining the recoverable amount of either the acquired entity, if it has not been integrated, or the entire group of entities that the goodwill has been integrated into.

- Reversal of prior impairment losses is permitted in certain instances.
FRS 11 applies to purchased goodwill and fixed assets except financial instruments, investment properties, and certain oil exploration assets. It also applies to investments in subsidiaries, associates and joint ventures. The scope of Section 27 Impairment of assets is wider and includes inventory. The guidance on the impairment of inventory in previous UK GAAP is contained in the measurement rules of SSAP 9.

FRS 11 refers to income generating units (IGUs) whereas FRS 102 refers to CGUs. This may lead to differences in practice, e.g. the level at which groups of assets are tested for impairment.

The requirements as to when an impairment test is performed are similar to FRS 102, except that:

- Annual impairment testing is also required for tangible fixed assets with lives of over 50 years.
- Goodwill and intangible assets being amortised over a period of 20 years or less are tested for impairment at the end of the first full financial year following acquisition but thereafter only if there is an indicator of impairment.
- Annual impairment testing is required for goodwill and other intangible assets that are amortised over a period exceeding 20 years, or that are not amortised.

When an acquired business is merged with an existing business, the notional value of pre-existing internally generated goodwill is added to the carrying amount of the IGU for the purposes of performing the impairment test. Any subsequent impairment losses are allocated pro rata between the purchased goodwill and the notional pre-existing internally generated goodwill. Only the amount of the loss allocated against the purchased goodwill is recognised in the financial statements.

When an impairment test based on value in use has been performed, the actual cash flows of the IGU are monitored for the next five years. If the actual cash flows fall short of the cash flows forecast in the value in use test such that an impairment loss might have resulted had the actual cash flows been used, the calculations are then re-performed using the actual cash flows. Any additional impairment loss is recognised in the current period.

The presentation of impairment losses is similar to FRS 102, except that it is necessary to assess whether impairment losses relate to operations and so are charged in arriving at operating profit, or relate to a disposal and thus are recognised as part of the gain or loss on disposal.

Reversals of impairment losses relating to intangible assets are recognised only if:

(a) the assets have a readily ascertainable market value and the net realisable value of the assets based on that market value has increased to above the asset’s impaired carrying amount; or
(b) an external event caused the recognition of the impairment loss in a previous period and subsequent external events clearly and demonstrably reverse the effects of that event in a way that was not foreseen in the original impairment calculations.

Increases in value in use as a result of the passage of time or the occurrence of forecast cash outflows do not constitute reversals of impairment losses.

FRS 11 provides much more detailed guidance on areas where FRS 102 is silent, e.g. preparation of the cash flow projections for a value in use calculation.

FRS 11 requires greater disclosure than FRS 102 including, when the impairment loss is measured by discounting cash flows, the discount rate, cash flow period and growth rate used in the calculations.
27 Impairment of assets

27.1 This section of FRS 102 applies to the impairment of all assets other than those listed below. Their impairment is considered in the other sections indicated:

(a) Assets arising from construction contracts – see Section 23 Revenue.
(b) Deferred tax assets – see Section 29 Income tax.
(c) Assets arising from employee benefits – see Section 28 Employee benefits.
(d) Financial assets – see Section 11 Basic financial instruments or Section 12 Other financial instruments issues.
(e) Investment property measured at fair value – see Section 16 Investment property.
(f) Biological assets related to agricultural activity measured at fair value less estimated costs to sell – see Section 34 Specialised activities. [FRS102.27.1]
(g) Deferred acquisition costs and intangible assets arising from contracts within the scope of FRS 103 Insurance contracts (once issued). [FRS102.27.1A]

Impairment of inventories

27.2 At each reporting date an entity assesses whether any inventories are impaired. Impairment is assessed by considering whether the selling price less the costs to complete and sell an item of inventory (or group of inventory items) is greater than its carrying value. [FRS102.27.2] When it is impracticable to assess items of inventory individually for impairment, items relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area may be grouped. [FRS102.27.3]

27.3 When inventory is impaired the carrying value is reduced to the selling price less costs to complete and sell. The reduction is recognised as an impairment loss immediately in profit or loss. [FRS102.27.2]

27.4 A new assessment of selling price less costs to complete and sell is made at each reporting date. An inventory impairment loss is reversed when either the circumstances that previously caused the impairment no longer exist, or the selling price less costs to complete and sell has increased due to changes in economic circumstances. The amount reversed is limited to the original impairment loss such that the carrying amount of inventory is the lower of cost and the updated selling price less costs to complete and sell. [FRS102.27.4]

Impairment of assets other than inventories

27.5 An impairment test is carried out when an impairment indicator exists. The existence of impairment indicators is considered on an annual basis. If an impairment indicator exists, an estimate of recoverable amount is prepared. [FRS102.27.7] When the recoverable amount of an asset is less than its carrying amount an impairment loss is recognised immediately in profit or loss unless the asset is carried at a revalued amount. If the asset is carried at a revalued amount, the loss is treated as a revaluation loss in accordance with the section of the standard that applies to that asset (see, for example, paragraph 17.18 of this publication). [FRS102.27.6]

27.6 The impairment loss is equal to the difference between the carrying amount and the recoverable amount of the asset. [FRS102.27.5]

27.7 Measuring the recoverable amount of an asset may require an entity to forecast the asset’s cash flows. When it is not possible to estimate the recoverable amount of the individual asset, i.e. the asset does not generate cash flows individually, the recoverable amount of the CGU to which the asset belongs is estimated. [FRS102.27.8]

27.8 An asset’s CGU is the smallest identifiable group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. [FRS102.27.8]
IFRS27.1 Goodwill, indefinite-lived intangible assets and intangible assets not yet available for use are tested annually for impairment under IAS 36, regardless of whether there is an indication of impairment.

IFRS27.2 Under IAS 36, the CGU or group of CGUs to which goodwill is allocated for impairment testing purposes represents the lowest level at which goodwill is monitored for internal management purposes, and cannot be larger than an operating segment before aggregation as defined by IFRS 8.

IFRS27.3 Under IAS 36, goodwill cannot always be allocated on a non-arbitrary basis to an individual CGU, only to groups of CGUs. As a result, the lowest level within the entity at which the goodwill is monitored for internal management purposes may comprise a number of CGUs to which the goodwill relates, but to which it cannot be allocated. In contrast, when goodwill cannot be allocated to an individual CGU (or groups of CGUs) on a non-arbitrary basis under FRS 102, then for the purposes of testing goodwill the entity tests the impairment of goodwill by determining the recoverable amount of either:

(a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated.
   Integrated means the acquired business has been restructured or dissolved into the reporting entity or other subsidiaries; or

(b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.

IFRS27.4 Under IAS 36 an impairment of goodwill cannot be reversed.

IFRS27.5 Increases in value in use as a result of the passage of time or the occurrence of forecast cash outflows do not constitute reversals of impairment losses.

IFRS27.6 IAS 36 provides much more detailed guidance on areas where FRS 102 is silent, e.g. preparation of the cash flow projections for a value in use calculation.

IFRS27.7 IAS 36 has more extensive disclosure requirements than FRS 102.
Indicators of impairment

27.9 The following sources of information are considered, as a minimum, when assessing if an indicator of impairment may exist: [FRS102.27.9]

*External sources of information*

(a) Significant decline in an asset’s market value greater than that which would be expected due to the passage of time or normal use.

(b) Significant adverse changes in the technological, market, economic or legal environment in which the entity operates have either occurred, or will occur in the near future.

(c) Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect materially the discount rate used in calculating an asset’s value in use and decrease the asset’s fair value less costs to sell.

(d) The carrying amount of the net assets of the entity exceeds the estimated fair value of the entity as a whole.

*Internal sources of information*

(e) There is evidence of obsolescence or physical damage of an asset.

(f) Significant adverse changes have taken place or are expected to take place in the near future which affect the use of an asset. This includes the asset becoming idle, restructuring or disposal plans, or reassessment of the asset’s useful life.

(g) Evidence from internal reporting that the economic performance of an asset (including operating results and cash flows) is, or will be, worse than expected.

27.10 If there is an indicator of impairment, this may also signify that the entity is required to review the remaining useful life, the residual value for the asset or the depreciation or amortisation method and, if necessary, adjust them in accordance with the section of this FRS applicable to the asset. This may be necessary even if no impairment loss is recognised for the asset.

Measuring recoverable amount

27.11 The recoverable amount is the higher of an asset’s or CGU’s fair value less costs to sell and its value in use. [FRS102.27.11]

27.12 However, if there is no reason to believe that an asset’s value in use materially exceeds its fair value less costs to sell, the asset’s fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal. [FRS102.27.13]

Fair value less costs to sell

27.13 Fair value (see paragraph 11.25 of this publication for guidance) less costs to sell is the amount obtainable from the sale of an asset or CGU in an arm’s length transaction between knowledgeable, willing parties, less the costs of disposal. A binding sale agreement in an arm’s length transaction or a market price in an active market provides the best evidence of fair value less costs to sell. If there is no binding sale agreement and no active market, then the fair value less costs to sell is determined based on the best information available. Recent transactions for similar assets in the same industry are considered. [FRS102.27.14]

27.14 Any restrictions imposed on an asset are considered in establishing its fair value less costs to sell. If relaxation of these restrictions is required before the asset can be sold then the cost of this relaxation is included in the costs to sell. An asset with a restriction that would affect any purchaser of the asset may have a lower fair value than an asset with no such restriction. [FRS102.27.14A]
Value in use

27.15 Value in use is the present value of the future cash flows expected to be derived from an asset or CGU. This present value calculation involves the following steps:

(a) estimating the entity-specific future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and
(b) applying the appropriate market participant-based discount rate to those future cash flows. [FRS102.27.15]

27.16 Estimates of future cash flows do not include cash flows from financing activities or income tax. [FRS102.27.18] In addition, the estimates of future cash flows do not include those expected to arise from future restructuring to which management is not yet committed, or from improving or enhancing the asset’s future performance. [FRS102.27.19]

27.17 The discount rate used in the present value calculation is a pre-tax rate that reflects current market assessments of the time value of money, and the risks specific to that asset that are not reflected in the cash flows. [FRS102.27.20]

27.18 Valuation based on cash flows may not be appropriate for assets held for their service potential. For such assets the present value of the future service potential, being the asset’s remaining service potential plus net proceeds from disposal, will be more appropriate than cash flows. This amount may equate to the costs avoided by retaining the asset. Suitable measurement models may include calculating value in use by estimating the costs avoided in owning the asset, or the asset’s depreciated replacement cost. [FRS102.27.20A]

Recognising and measuring an impairment loss for a CGU

27.19 An impairment loss is recognised to the extent that the carrying amount of an asset or CGU exceeds its recoverable amount. Any impairment loss is allocated first by writing down the goodwill that is allocated to the CGU (if any) and then pro rata, based on their respective carrying amounts, to the CGU’s other assets. However, no asset is written down below the higher of its recoverable amount (if determinable) and zero. Any excess impairment loss in respect of an asset is allocated pro rata to the other assets in the CGU. [FRS102.27.21-23]

Impairment of goodwill – additional requirements

27.20 Goodwill is normally tested for impairment at the level of a CGU or a group of CGUs. [FRS102.27.24] Goodwill is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination from which it arose. This is irrespective of whether other assets or liabilities of the acquiree are assigned to those CGUs. [FRS102.27.25]

27.21 Non-controlling interests are measured at the acquisition date at their proportionate share of the acquiree’s identifiable net assets, which exclude goodwill. Goodwill attributable to non-controlling interests is not recognised in the parent’s consolidated financial statements. Therefore, for the purposes of impairment testing, the carrying amount of goodwill allocated to a CGU or group of CGUs in which there is a non-controlling interest is notionally grossed up to include the unrecognised goodwill attributable to the non-controlling interests. [FRS102.27.26] This amount is then compared to the recoverable amount of the related CGU or group of CGUs.

27.22 If goodwill cannot be allocated to an individual CGU (or group of CGUs) on a non-arbitrary basis, it is then tested for impairment by determining the recoverable amount of either:

(a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated or dissolved into the reporting entity; or
(b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated. [FRS102.27.27]
Reversal of an impairment loss

27.23 An impairment loss is reversed in subsequent periods if, and only if, the reasons for the impairment loss have ceased to apply. [FRS102.27.28]

27.24 When an impairment loss has been recognised previously, the entity assesses at each reporting date whether there is an indication that that impairment loss has reversed. The indications of potential reversal are the opposite of the indications of impairment (see paragraph 27.9 of this publication). If there is such an indication and the recoverable amount of the impaired asset or CGU subsequently increases, then all or part of the impairment loss is reversed. The procedure for determining that reversal depends on whether the initial impairment was calculated based on the recoverable amount of an individual asset or a CGU. [FRS102.27.29]

27.25 When the impairment loss was based on the recoverable amount of an individual asset, a revised estimate of recoverable amount is prepared at the current reporting date. The maximum amount of the reversal is the lower of:

(a) the amount necessary to bring the carrying amount of the asset to its recoverable amount; and

(b) the amount necessary to restore the asset to its pre-impairment carrying amount less subsequent depreciation or amortisation that would have been recognised.

27.26 A reversal of an impairment loss is recognised in profit or loss unless the asset is revalued. If the asset is carried at revalued amount (e.g. the revaluation model for property, plant and equipment) any reversal of an impairment loss of a revalued asset is treated as a revaluation increase in accordance with the relevant section of FRS 102 for property, plant and equipment (see paragraph 17.18 of this publication). [FRS102.27.30(b)]

27.27 The depreciation or amortisation charge for the asset for the remainder of its useful life after the impairment reversal reflects its revised carrying amount, less its residual value (if any). [FRS102.27.30(d)]

27.28 When the impairment loss was calculated from the recoverable amount of a CGU including the asset, a revised estimate of recoverable amount of that CGU is prepared at the current reporting date. If the estimated recoverable amount of the CGU exceeds its carrying amount, that excess is a reversal of an impairment loss. [FRS102.27.31(a),(b)]

27.29 The reversal is allocated first to the assets of the CGU (other than goodwill) pro rata with their carrying amounts, and then to goodwill.

27.30 The amount of the reversal for any asset is capped in the same way as set out in paragraph 27.25 of this publication. The increases in carrying amount are treated as reversals of impairment losses for individual assets and, for assets not revalued, recognised immediately in profit or loss. If an asset is carried at revalued amount (e.g. the revaluation model for property, plant and equipment) any reversal of an impairment loss of a revalued asset is treated as a revaluation increase in accordance with the relevant section of FRS 102 for property, plant and equipment (see paragraph 17.18 of this publication). [FRS102.27.31(b)]

27.31 When the reversal cannot be allocated to an asset due to the cap, it is apportioned to the other assets of the CGU based on the order in paragraph 27.29 of this publication. [FRS102.27.31(d)]

27.32 The depreciation or amortisation for each asset in the CGU is adjusted after the reversal on the same basis as set out in paragraph 27.27 of this publication. [FRS102.27.31(e)]
Overview of requirements

- Employee benefits are all types of consideration given to employees (including directors and management). Employee benefits include share-based payments but these are covered in Section 26 Share-based payment.
- Employee benefits are classified as either short-term, post-employment, other long-term, or termination benefits.
- Short-term benefits are recognised at the undiscounted amount expected to be paid for the services rendered in the period.
- There are two types of post-employment benefit plan: defined contribution and defined benefit plans.
- Contributions payable to a defined contribution plan are recognised as an expense in the period to which they relate.
- When accounting for defined benefit plans, a net defined benefit liability (or asset) representing the obligations under the plan, net of any plan assets, is recognised.
- Actuarial gains and losses and the difference between the total return on plan assets and the amount included in net interest are recognised in other comprehensive income. All other costs of a defined benefit plan are recognised in profit or loss.
- When a defined benefit plan is introduced or changed in the period, the net defined benefit liability is adjusted accordingly and the effect of the change is recognised in profit or loss.
- A surplus in a defined benefit plan is recognised as an asset only when the surplus is expected to be recovered through reductions in future contributions or a refund.
- A group defined benefit plan is accounted for by members of the group in line with the contractual agreement or policy in place. If there is no such agreement, the entity legally responsible for the plan recognises its cost and the net defined benefit liability (asset), with other members recognising the cost of their contributions for the period.
- Participation in a multi-employer defined benefit plan (which does not include plans for entities under common control) may be accounted for on a defined contribution basis if insufficient information is available to allow defined benefit accounting.
- Entities in a non-group multi-employer plan, with an agreement to fund the plan deficit, recognise a liability for contributions payable arising under the plan agreement to the extent that they relate to the deficit.
- A liability is recognised for ‘other long-term benefits’ measured at the net of the present value of the obligation and the fair value of any plan assets at the reporting date.
- Termination benefits are recognised as an expense when incurred. A provision is recognised only when the entity is demonstrably committed to terminating employment before the normal retirement date or offering voluntary redundancy.
vs previous UK GAAP

Applicable standards: FRS 12, FRS 17, UITF 35

pUK28.1 FRS 17 has a narrower scope than FRS 102, dealing only with retirement benefits. There is no specific UK standard that deals with the accounting for short-term employee benefits such as holiday pay and sick pay, although many of these would be covered by the general principles of accounting for provisions (FRS 12).

pUK28.2 Defined benefit multi-employer plans, which include group plans, are accounted for as defined benefit plans other than in two situations:

- Employer contributions are set only in relation to the current service period and any deficit or surplus arising from past service of the entity’s own employees or other members of the plan does not affect the current contribution level. In this case the plan is accounted for as a defined contribution plan.

- When the employer contributions are affected by a plan surplus or deficit but the employer cannot identify its share of the assets and liabilities of the plan on a reasonable and consistent basis, the plan is accounted for as a defined contribution plan but with additional disclosure requirements.

pUK28.3 When members of a group participate in a group plan, the second bullet above might apply to some or all of the individual participating entities (including, possibly, the sponsoring entity). They would therefore account for the plan as a defined contribution plan, with additional disclosures. It is therefore possible under FRS 17 that no individual entity within the group would recognise any part of the defined benefit obligation for the plan.

pUK28.4 Obligations arising from deficit funding agreements for multi-employer plans accounted for on a defined contribution basis are not recognised under previous UK GAAP.

pUK28.5 FRS 17 requires all defined benefit plans to follow the projected unit credit method for valuing the defined benefit obligation. A full actuarial valuation for the plan is obtained at least every three years by a professionally qualified actuary. The actuary updates the most recent valuation to reflect current conditions at each balance sheet date.

pUK28.6 Losses on curtailment or settlement of a plan are measured when the employer becomes demonstrably committed to the transaction and are recognised in profit or loss at that date. Gains are recognised only when irrevocable agreement has been received from all parties that need to agree.

pUK28.7 Past service costs (increases in plan liabilities related to employee service in prior periods) arise when an employer makes a commitment to increase the level of benefit provided. They are recognised in profit or loss on a straight-line basis over the period in which the increased benefits vest.

pUK28.8 A defined benefit surplus is recognised to the extent that the employer controls its use either through the right to a refund or a reduction in future contributions. The amount of asset recognised is limited to the amount of refund agreed with the pension plan trustees at the balance sheet date and the present value of future contributions through which the asset could be recovered, measured using the FRS 17 assumptions.

pUK28.9 Under FRS 17 the interest on plan assets is recognised in profit or loss based on the long-term expected rates of return on the assets of the plan.
28.1 Employee benefits are all forms of consideration given to employees (including directors and management) in exchange for service rendered. Share-based payment arrangements are covered in Section 26 Share-based payment. [FRS102.28.1]

28.2 Four types of employee benefit are covered in this chapter:
(a) short-term employee benefits – benefits that are expected to be settled wholly before 12 months after the end of the period when the employee services were rendered (excluding termination benefits);
(b) post-employment benefits – benefits due to employees after the end of their employment (excluding termination benefits and short-term benefits);
(c) other long-term employee benefits – benefits that are not short-term, termination or post-employment benefits; and
(d) termination benefits – benefits payable in exchange for employment termination as a result of a decision to terminate an employee’s employment before the normal retirement date or as a result of voluntary redundancy. [FRS102.28.1]

General recognition principle for all employee benefits

28.3 The cost of employee benefits earned for service rendered to the entity is recognised as a liability and an expense (unless it is capitalised under another section of FRS 102). The liability is recognised net of amounts that were paid in the period, either to the beneficiaries or as contributions to a separate fund. Contributions to an employee benefit fund that is an intermediate payment arrangement are accounted for in accordance with FRS 102.9.33-38 – see paragraphs 9.21 to 9.24 of this publication. If the amount paid exceeds the liability, an asset is recognised only if the entity has the right to reduce future payments or to receive a cash refund as a result of that excess payment. [FRS102.28.3]

Short-term employee benefits

28.4 Short-term employee benefits are items such as wages, salaries, national insurance, holiday pay, sick pay, non-monetary benefits (such as housing or free or subsidised goods) and bonuses for which the obligation is expected to be settled wholly within 12 months of the end of the period in which the employee service was provided. [FRS102.28.4] These benefits are measured at the undiscounted amount expected to be paid in exchange for the service rendered in that reporting period. [FRS102.28.5]

28.5 Short-term compensated absences include items such as holiday pay and sick leave. When these absences accumulate, i.e. can be carried forward to future periods, the cost is recognised in the period in which it accrues at the undiscounted amount expected to be paid. The amount is presented as a liability due within one year. [FRS102.28.6] The cost of non-accumulating compensated absences – i.e. those that are lost if not used in the current period – is recognised when the absence occurs. [FRS102.28.7]

28.6 The cost of a bonus (or profit-share) is recognised when there is a legal or constructive obligation to pay the bonus as a result of past events, and the amount can be estimated reliably. [FRS102.28.8]

Post-employment benefits: distinction between defined contribution plans and defined benefit plans

28.7 Post-employment benefits are items such as pensions, post-employment life assurance and post-employment medical care. Post-employment benefit plans are formal or informal arrangements providing benefits to employees. [FRS102.28.9] Post-employment benefit plans include both funded and unfunded plans.

28.8 There are two types of post-employment benefit plan: defined contribution plans and defined benefit plans.
(a) Defined contribution plans require an employer to make fixed contributions into a separate entity (a fund). The employer has no further legal or constructive obligation to make additional contributions or to guarantee benefits to the employee: the employee bears the risk of the value of the benefit.
(b) All other post-employment plans are defined benefit plans. They commit an employer to provide a certain level of benefit to employees post-employment. The employer bears both the investment and the actuarial risk of providing those benefits. If the investment or actuarial risk improves or worsens, the employer’s obligation decreases or increases accordingly. [FRS102.28.10] If a post-employment benefit plan is not a defined contribution plan then it is a defined benefit plan.
**vs EU-IFRS**

Applicable standards: IAS 19 (2011), IFRIC 14

IFRS28.1 IFRIC 14 includes detailed guidance on calculating the asset ceiling when there are minimum funding requirements, which may in some cases give rise to a reduced asset or an additional liability. The impact is measured using the assumptions made for funding purposes.

IFRS28.2 Under IAS 19, if a termination is linked to a restructuring then the cost and liability are recognised when the entity is demonstrably committed to the restructuring, which may be before a formal plan is in place for the termination.

IFRS28.3 Under IAS 19 a curtailment occurs when an entity significantly reduces the number of employees covered by a plan. All other reductions in benefits are plan amendments. This difference has no practical implications.
28.9 When an employer takes out an insurance policy to fund a post-employment benefit plan and pays insurance
premiums, the plan is accounted for as a defined contribution plan unless the entity has a legal or constructive
obligation either to pay or to guarantee the employee benefits directly when they become due. If such a constructive
or legal obligation exists, the plan is accounted for as defined benefit plan. [FRS102.28.12]

Multi-employer and state plans

28.10 A multi-employer plan pools the assets of a defined benefit or defined contribution plan provided by the
contributions from multiple entities not under common control. Those assets are then used to provide benefits to
the employees of those entities. Contribution and benefit levels are determined without regard to the identity of the
entity that employs the employees concerned. Group plans are discussed in paragraphs 28.14 to 28.16 of this
publication. [FRS102.GL]

28.11 A state employee benefit plan is established by legislation to cover entities in a particular industry or category. It is
operated by either government or another autonomous agency that is not subject to control or influence by the
entity. [FRS102.GL]

28.12 Multi-employer and state plans are classified as defined benefit or defined contribution plans according to the plan’s
terms, including any constructive obligation that may exist. If insufficient information is available for a multi-employer
or state defined benefit plan to allow the employer to adopt defined benefit accounting, the plan is accounted for as
a defined contribution plan. [FRS102.28.11]

28.13 If an entity has entered into an agreement with the multi-employer plan or state plan that determines how the entity
will fund a deficit, the entity recognises a liability for the contributions payable that arise from the agreement (to the
extent that they relate to the deficit) and the resulting expense in profit or loss. [FRS102.28.11A]

Group plans

28.14 A group plan is a pension plan shared by entities under common control. The terms of a plan will determine whether
it is a defined contribution or a defined benefit plan. See paragraph 28.8 of this publication for the difference
between defined contribution and defined benefit plans.

28.15 Entities participating in a defined benefit plan shared by entities under common control obtain information about the
plan. The defined benefit obligation of a group plan is recognised on at least one individual entity balance sheet
within the group. Individual group entities recognise their share of the cost of the plan in their individual accounts
as follows:

• If a contractual agreement or stated policy on charging the plan cost to group entities exists, then each entity
  recognises its share of plan cost according to this policy. The balance sheet consequences are discussed in the
  following paragraph.

• If no such agreement exists, then the cost is recognised in the individual accounts of the entity legally responsible
  for the defined benefit plan. Other group entities recognise the cost equal to their contributions payable for the
  period. [FRS102.28.38]

28.16 The net defined benefit cost is calculated by reference to both the defined benefit obligation and the fair value of the
plan assets. Therefore, the consequence of an entity recognising its share of plan cost under an agreement or policy
is that its share of the relevant net defined benefit liability (or asset) is recognised in its individual financial
statements. [FRS102.ACA.76]

Post-employment benefits: defined contribution plans

28.17 Contributions payable to defined contribution plans are recognised as an expense in the period to which they relate,
unless the cost is required to be recognised under FRS 102 as part of the cost of an asset, e.g. property, plant and
equipment. At the period end a liability is recognised for any amounts owed to the plan. If contributions exceed the
amount due to the plan, an asset is recognised for the excess. [FRS102.28.13]

28.18 For a plan that is accounted for as a defined contribution plan, a liability for contributions payable not expected to be
settled wholly within 12 months is measured at its present value using a discount rate specified in paragraph 28.22
of this publication. The unwinding of the discount is recognised in profit or loss as a finance cost. [FRS102.28.13A]
Post-employment benefits: defined benefit plans

28.19 When accounting for defined benefit plans, an entity recognises a net defined benefit liability representing its obligations under the plan net of any plan assets. The standard explains that the cost of the plan is the net change in the net defined benefit liability during the reporting period. However, changes caused by contributions to the plan will not form part of the cost. [FRS102.28.14]

28.20 The net defined benefit liability is measured as the present value of the defined benefit obligation, as set out in the plan rules, at the reporting date, less the fair value at the reporting date of any plan assets out of which the obligation is to be settled. Plan assets include those held both by a long-term employee benefit fund and qualifying insurance policies. Generally, fair value is determined in accordance with the guidance discussed at paragraph 11.25 of this publication. However, when the asset is an insurance policy that exactly matches the amount and timing of some or all of the pension plan benefits, its fair value is deemed to be the present value of the related obligation. [FRS102.28.15, FRS102.GL]

28.21 The defined benefit obligation includes both vested and unvested benefits earned by the employees as a result of service provided in the current and previous periods, as well as the effects of benefit formulae that give greater benefits to later years of service. Such formulae generally lead in practice to straight-line attribution of the benefits. To ensure the defined benefit obligation reflects the best estimate of future cash flows, the actuarial assumptions used (including demographic variables such as retirement dates and mortality, and financial variables such as inflation) are unbiased and mutually compatible. [FRS102.28.16]

28.22 The defined benefit obligation is measured on a discounted present value basis. The discount rate used is the market yield at the reporting date on high quality corporate bonds with a currency and term consistent with the expected period of future payments. If no high quality corporate bonds are available for comparison, the yield of government bonds is used instead. [FRS102.28.17]

Actuarial valuation method

28.23 The projected unit credit method is an actuarial method that sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation (sometimes known as the accrued benefit method prorated on service or as the benefit/years of service method). [FRS102.GL]

28.24 An entity uses the projected unit credit method to measure the defined benefit obligation. This method requires actuarial assumptions to be made about, for example, the discount rate, employee turnover, mortality and expected medical cost trends (for defined benefit medical plans). [FRS102.28.18]

28.25 FRS 102 does not require an actuarial valuation to be carried out annually or by an independent actuary. If actuarial assumptions have not changed significantly, the most recent actuarial valuation can be adjusted for the changes in demographics (e.g. employee numbers and salary costs). [FRS102.28.20]

Plan introductions, changes, curtailments and settlements

28.26 When a defined benefit plan is introduced or benefits are changed in the period, the net defined benefit liability is adjusted accordingly. An increase or decrease in the liability is recognised as an expense or income (past service cost) in profit or loss in the period in which the change occurs. [FRS102.28.21]

28.27 A curtailment occurs when an entity either reduces the number of employees covered by the defined benefit plan, or amends the terms of a defined benefit plan. An amendment would normally be such that a material element of future service by current employees will no longer qualify for benefits, or will qualify for reduced benefits. Settlements are usually lump sum cash payments made to, or on behalf of, the plan participants in exchange for the extinguishment of the right to receive future benefits from the entity. If the plan is curtailed or settled, the defined benefit obligation is decreased or eliminated, with the resultant gain or loss (including any change in plan assets) recognised in profit or loss in the period in which the curtailment or settlement occurs.

Defined benefit plan asset

28.28 If the defined benefit obligation is less than the fair value of the plan assets, the plan has a surplus. A surplus is recognised as an asset only when it can be recovered either through a reduction in future contributions or a refund from the plan. [FRS102.28.22] FRS 102 does not specify the assumptions to be used in assessing the amount of a surplus recoverable through reduced contributions. Any restriction in the amount of a surplus that can be recognised affects both the net interest reported in profit or loss and the remeasurement in respect of plan assets. [FRS102.24A,B]
Recognition

28.29 The cost of a defined benefit plan includes:
(a) the change in the net defined benefit liability from employee service in the reporting period (i.e. current service cost);
(b) net interest on the net defined benefit liability in the period – measured as the balance sheet net defined benefit liability multiplied by the discount rate;
(c) the change in the net defined benefit liability as a result of the introduction of a new plan, a change to the existing plan, a curtailment or a settlement;
(d) actuarial gains or losses; and
(e) the difference between the actual return on plan assets and the amount included in net interest under (b) above. [FRS102.28.23,25]

28.30 The cost of the defined benefit plan arising from (a), (b) and (c) in paragraph 28.29 of this publication is recognised in profit or loss. [FRS102.28.23]

28.31 Some defined benefit plans require employees or third parties to contribute to the costs of the plan. Contributions by employees reduce the cost of the benefits to the entity. [FRS102.28.23]

28.32 The amounts arising from (d) and (e) in paragraph 28.29 of this publication represent the remeasurement of the net defined benefit liability and are recognised in other comprehensive income. These costs are not reclassified to profit or loss in a subsequent period. [FRS102.28.25A]

28.33 Actuarial gains and losses are changes in the present value of the defined benefit pension obligation resulting from:
(a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and
(b) the effects of changes in actuarial assumptions. [FRS102.GL]

28.34 An obligation exists under a defined benefit plan even if the benefits have not yet vested (e.g. are conditional on future employment). The service before the vesting date creates a constructive obligation. In determining the net defined benefit liability, the probability that some employees will satisfy the vesting conditions and that some will not is considered. The probability that the benefits will vest affects the measurement of the obligation but not its existence. [FRS102.28.26]

28.35 If defined benefits are reduced for amounts that will be paid to employees by government plans, the defined benefit obligation reflects this only when the government plans are enacted at the reporting date, and past history (or other reliable evidence) indicates that state benefits will change in a predictable manner. [FRS102.28.27]

28.36 When a reimbursement is virtually certain to be received from a third party to settle a defined benefit obligation, the asset is recognised separately from the liability and measured at fair value (unless it is an ‘exactly matching’ insurance policy, when deemed fair value is used (see paragraph 28.20 of this publication)). The asset is dealt with otherwise as if it were a plan asset. As a result, the net change in the fair value of recognised reimbursement rights is recognised as part of the cost of a defined benefit plan, with the interest element presented in profit or loss and other movements taken through other comprehensive income. [FRS102.28.28]

Other long-term employee benefits

28.37 Examples of other long-term employee benefits include long-term paid absences such as sabbatical leave, benefits for long service, long-term disability benefits, and bonuses or other compensation expected to be paid in part or in full 12 months or more after the end of the period in which they are earned. [FRS102.28.29]

28.38 A liability is recognised for other long-term benefits equal to the present value of the obligation at the reporting date less the fair value of any plan assets out of which the obligation will be settled. The change in the liability is accounted for in profit or loss or in the cost of an asset when permitted or required by FRS 102. The present value is calculated using a discount rate in line with the method described in paragraph 28.22 of this publication. [FRS102.28.30]
**Termination benefits**

28.39 Termination benefits are amounts payable to employees when their employment is terminated. Since termination benefits do not provide an entity with future economic benefits, they are recognised as an expense in profit or loss immediately when incurred. [FRS102.28.32] Termination may also result in a curtailment of retirement benefit obligations. [FRS102.28.33] A provision is created for termination benefits only when the entity is demonstrably committed to terminate employment before the normal retirement date, or to offer voluntary redundancy. [FRS102.28.34] An entity is demonstrably committed when it has a detailed formal plan in place, with no realistic possibility of withdrawal from the plan. [FRS102.28.35]

28.40 Termination benefits are recognised at the best estimate of the amount expected to be paid to settle the liability. [FRS102.28.36] When payment is not expected within 12 months after the end of the reporting period, the amount is discounted to present value. The present value is calculated using a discount rate in line with paragraph 28.22 of this publication. [FRS102.28.37]

28.41 Costs related to future services from employees who keep working after the entity has become demonstrably committed to the termination are not termination benefits because the entity is deriving future economic benefits from those services. The costs are therefore spread over the period of future service.

28.42 For example, a company offers its sales director a redundancy package of 100,000 if he leaves immediately or a package of 160,000 if he stays for a three month handover period. Assuming he takes the second offer, the additional 60,000 is spread over the three month service period, whereas the 100,000 is recognised as a liability when the entity is demonstrably committed to the termination.
Overview of requirements

• Current tax is tax payable on taxable profit in relation to the current or previous periods.

• Deferred tax is future tax payable as a result of transactions in current or previous periods and is recognised for virtually all timing differences, with certain specified exceptions, and for differences arising in a business combination.

• Deferred tax is not recognised on permanent differences.

• Current and deferred tax is calculated based on applicable rates that have been enacted or substantively enacted at the balance sheet date.

• Current and deferred tax assets and liabilities are not discounted.

• Withholding tax is included in the measurement of dividends paid and received; any withholding tax suffered is included in the tax charge.

• Tax is recognised in the same component of total comprehensive income, or equity, as its related transaction.

• Deferred tax liabilities are presented within provisions; deferred tax assets are presented within debtors.

• Current tax assets and liabilities and deferred tax assets and liabilities are each offset if, and only if, there is a legally enforceable right of set-off and intention to settle on a net basis or simultaneously.

• VAT and similar sales taxes are excluded from the presentation of turnover and expenses. Irrecoverable amounts are disclosed separately.
Applicable standards: SSAP 5, FRS 16, FRS 19

pUK29.1 FRSs 16 and 19 require all current and deferred tax income or expense for the period to be included in the statements of performance (i.e. profit and loss account or statement of total recognised gains and losses). FRS 102 requires tax to be charged/credited directly to equity if it relates to items that are also charged/credited directly to equity. For example, current tax on share issue costs is recognised in the profit and loss account under FRS 16, but recognised directly in equity under FRS 102.

pUK29.2 The disclosure requirements of FRS 102 differ from those of FRSs 16 and 19. For example, FRS 19 requires a reconciliation of the current tax charge or credit reported in the profit and loss account to profit before tax multiplied by the applicable tax rate, whereas FRS 102 requires a reconciliation of the total tax expense or income for the period (as included in profit or loss). In addition, FRS 102 requires an analysis of the major components of the aggregate tax charge/credit recognised in the financial statements to be given: FRSs 16 and 19 require this analysis to be given separately for tax recognised in profit or loss and other comprehensive income. Further, unlike FRS 19, FRS 102 does not require disclosure of movements in deferred tax balances in the period or of unrecognised deferred tax amounts.

pUK29.3 FRS 102 requires disclosure of the net reversal of deferred tax expected to occur in the period following the reporting period. This is not required under FRS 19.

pUK29.4 FRS 102 requires disclosure of the tax expense relating to discontinued operations; [FRS102.5.7D] FRS 16 does not.

pUK29.5 Under FRS 19 deferred tax may be discounted to reflect the time value of money.

pUK29.6 Under FRS 19 deferred tax is recognised on unremitted earnings of subsidiaries, associates and joint ventures only when the income has been accrued or there is a binding agreement in place to distribute the earnings.

pUK29.7 Under FRS 19 deferred tax is not recognised on revaluations of non-monetary assets for which there is no binding agreement to sell and the gain or loss on sale has not been recognised (unless the assets are continuously revalued to fair value through profit or loss).

pUK29.8 Under FRS 19 deferred tax is not recognised on rolled-over gains (arising on revaluations or disposals) until the assets into which the gains have been rolled over are sold.

pUK29.9 Under FRS 19 there is no recognition of deferred tax on fair value adjustments in a business combination unless these would be recognised by the acquired entity in its own financial statements (e.g. on the write down of inventories).
29 Income tax

FRS 102
Section 29

29.1 Income tax includes:

- all domestic and foreign taxes based on taxable profit; and
- tax payable on distributions of a subsidiary, associate or joint venture to the entity. [FRS102.29.1]

29.2 Current tax is tax payable in relation to the current or previous periods. Deferred tax is the future tax payable as a result of transactions in the current or previous periods. [FRS102.29.2]

29.3 Tax rates are substantively enacted when it is unlikely that any outstanding steps of the enactment process will affect the outcome as these stages, historically, have had no impact. A UK tax rate is regarded as having been substantively enacted if it is included in either:

(a) a Bill that has been passed by the House of Commons and is awaiting only passage through the House of Lords and Royal Assent; or

(b) a resolution having statutory effect that has been passed under the Provisional Collection of Taxes Act 1968. [FRS102.GL]

Current tax

29.4 A current tax liability is recognised for tax payable for the current and previous periods. If this is less than the amount of tax paid for these periods then a tax asset is recognised. An asset is also recognised if a tax loss can be carried back to relieve tax previously paid. [FRS102.29.3]

29.5 Current tax assets and liabilities are calculated using the tax rates enacted or substantively enacted at the balance sheet date. [FRS102.29.5]

29.6 Current tax liabilities are not discounted. [FRS102.29.17]

Deferred tax

29.7 Deferred tax is recognised for timing differences arising when items are included in a tax assessment in one period and recognised in the financial statements in another, [FRS102.29.6] except as follows:

(a) Deferred tax assets are recognised only to the extent that it is probable they are recoverable against future taxable profits or deferred tax liability reversals. [FRS102.29.7]

(b) Deferred tax on fixed assets is recognised when the tax allowance for the asset is received before or after the depreciation is recognised. The deferred tax is reversed if and when all conditions for retaining the tax allowance are met. [FRS102.29.8]

(c) Income or expenses from subsidiaries, associates, branches or joint ventures result in deferred tax unless the entity can control the reversal of timing differences and it is probable they will not reverse. [FRS102.29.9]

29.8 Deferred tax is also recognised in business combinations in respect of any additional tax consequences of any differences between the amount that will be deducted or assessed for tax and the fair value of acquired assets and liabilities, other than in respect of goodwill. There is a corresponding adjustment to goodwill. [FRS102.29.11]

29.9 With the exception of differences arising in a business combination, permanent differences do not result in the recognition of deferred tax. These are differences due to items being disallowed for tax purposes or non-taxable, or the amount of the tax charges or allowances differing from the amount of the related income or expense. [FRS102.29.10]

29.10 Deferred tax is measured using tax rates enacted or substantively enacted at the balance sheet date that are expected to be applicable to the reversal of the timing difference. [FRS102.29.12] If different tax rates apply to different profit levels an entity applies an average expected tax rate. [FRS102.29.13]
IFRS29.1 Under IAS 12 deferred tax is recognised on a ‘temporary difference’ basis rather than the ‘timing difference plus’ basis of FRS 102. This can result, in some cases, in wider recognition of deferred tax. For example, IAS 12 includes specific guidance on deferred tax on share-based payments, requiring the deferred tax on any excess temporary difference over the cumulative charge to profit or loss to be recognised directly in equity. Under FRS 102 any tax deduction in excess of the profit and loss account charge is treated as a permanent difference and no deferred tax is recognised on this.

IFRS29.2 Another example of when the recognition of deferred tax under IAS 12 differs from FRS 102 is when legislation changes the amount of future tax relief relating to an asset. Under IAS 12 this would lead to a change in the tax base of the asset and hence a change in the temporary difference and related deferred tax balance. Under FRS 102, the timing difference and related deferred tax balance are unchanged.

IFRS29.3 Under IAS 12 a deferred tax asset may be recognised on a deductible temporary difference arising on the initial recognition of tax-deductible goodwill. Under FRS 102 no deferred tax is recognised in relation to the initial recognition of any (positive) goodwill.

IFRS29.4 Under IAS 12, even if the conditions for retaining tax allowances are met, deferred tax is still recognised. Under FRS 102 the deferred tax would be reversed in this situation.

IFRS29.5 IAS 12 specifically requires the consideration of the expected manner of recovery of the asset or settlement of the liability when measuring deferred tax.

IFRS29.6 IAS 12 generally includes more detailed disclosure requirements than FRS 102, including information in relation to unrecognised deferred tax amounts. However, FRS 102 requires disclosure of the net reversal of deferred tax expected to occur in the period following the reporting period; this is not required under IAS 12. In addition, FRS 102 requires an analysis to be given of the major components of the aggregate tax charge/credit recognised in the financial statements; IAS 12 is less prescriptive than this and such an analysis is most often given only for tax recognised in profit or loss.

IFRS29.7 IAS 1 requires current tax to be presented separately on the face of the balance sheet; FRS 102 does not.
29.11 However, if tax rates vary depending on whether or not a dividend is paid, an entity applies the rate when no dividend is paid to calculate its current and deferred tax until it recognises a dividend liability. It then recognises the ensuing changes to current or deferred tax. [FRS102.29.14]

29.12 Further, deferred tax in relation to revalued fixed assets that are not depreciable (i.e. do not have a limited useful life) and investment properties carried at fair value is measured using the tax rates that apply on sale of the asset. [FRS102.29.15-16] Deferred tax on investment properties that have a limited useful life and for which the entity aims to consume substantially all of the property’s economic benefits over time is measured at the tax rates that are expected to apply to the reversal of the timing difference. [FRS102.29.12,16]

29.13 Deferred tax assets or liabilities are not discounted. [FRS102.29.17]

Presentation

29.14 Changes in current or deferred tax assets or liabilities are recognised as a tax expense in the same place as the related transaction (i.e. profit or loss (continuing or discontinued), other comprehensive income or equity). [FRS102.29.22]

29.15 Deferred tax liabilities are presented within provisions. Deferred tax assets are presented within debtors. [FRS102.29.23]

29.16 Offsetting of current tax assets and liabilities is allowed only when an entity legally can, and intends to, offset the balances and settle on a net basis or simultaneously. If those conditions are met, offset is required. [FRS102.29.24] Offsetting of deferred tax asset and liabilities is allowed only when an entity has a legal right to offset current tax assets and liabilities, and the deferred tax assets and liabilities relate to taxes levied by the same taxation authority on either the same taxable entity or different taxable entities that intend to settle current tax liabilities and assets either on a net basis or simultaneously. Again, if those conditions are met, offset is required. [FRS102.29.24A]

Withholding tax on dividends

29.17 The measurement of gross dividends paid and received includes any withholding tax suffered but excludes other taxes e.g. attributable tax credits. [FRS102.29.18-19]

29.18 For example, a company declares a dividend of 900. A withholding tax of 10 percent is applied in the local jurisdiction. The receiving entity is entitled to an attributable tax credit of 20 percent. The dividend income is recorded at an amount of 900 by the receiving entity, and the withholding tax suffered of 90 is recognised as a tax expense. The dividend income is not grossed up to reflect the effect of the 20 percent attributable tax credit.

Value Added Tax (VAT) and other similar sales taxes

29.19 VAT and other similar sales taxes (if recoverable) are excluded from turnover and expenses shown in profit or loss. Irrecoverable amounts are included in the cost of a related asset or the amount of any other separately disclosed related items in the financial statements, when practicable and material. [FRS102.29.20]
Foreign currency translation
Overview of requirements

- This section of FRS 102 applies to transactions in foreign currencies and translation of foreign operations. Hedge accounting of foreign currency risk is dealt with in Section 12 Other financial instruments issues.

- An entity identifies its functional currency as the currency of the primary economic environment in which it operates.

- Primary factors that influence the determination of functional currency are the currencies that mainly influence sales prices, labour costs and material costs. Secondary factors include the currencies in which borrowings are denominated and settled, and in which operating cash receipts are normally retained.

- The functional currency of a foreign operation (which may be the same as that of the reporting entity) is determined also by considering the operation’s autonomy, cash flows, financing and volume of intercompany transactions.

- The functional currency changes only when the underlying nature of the business has changed. A change in functional currency is accounted for prospectively.

- Foreign currency transactions are translated at the spot rate at the date of the transaction. Monetary items are retranslated at the closing rate at the period end. The profit or loss on retranslation is recognised in the income statement in the period in which it arises unless the monetary item forms part of the net investment in a foreign operation.

- Non-monetary items measured at historical cost are translated at the exchange rate at the date of the transaction. Non-monetary items held at fair value use the exchange rate at the date that the fair value is determined.

- When a monetary item is receivable from or payable to a foreign operation and settlement is unlikely in the foreseeable future, this is treated as part of the net investment in the foreign operation to reflect the substance of the transaction.

- Foreign exchange differences on retranslation of monetary assets that form part of the net investment in a foreign operation are recognised in other comprehensive income (OCI) in the reporting entity’s consolidated accounts and in profit or loss in either its separate financial statements or those of the foreign operation, as appropriate.

- Financial statements may be presented in any presentation currency. To translate from functional to presentation currency, assets and liabilities are translated at the closing rate at the balance sheet date and items of income and expense at the exchange rate on the date of the transaction. All resulting exchange differences are taken to OCI. For practical reasons, an average rate for the period may be used to translate items of income and expense. Exchange gains and losses taken to OCI are not recycled.

- A foreign operation is translated to the group’s presentation currency as noted above. Exchange differences arising are recognised in OCI and are not recycled.
vs previous UK GAAP – FRS 26 adopters
Applicable standards: FRS 23, UITF 19, UITF 21, UITF 46

pUK30.1 FRS 26 adopters should refer to the ‘vs EU-IFRS’ section as the requirements of FRS 23 are identical to those of IAS 21. FRS 26 and associated standards are mandatory for entities listed on an EU-regulated market and those applying the fair value accounting rules of the Companies Act.

vs previous UK GAAP – non-FRS 26 adopters
Applicable standards: SSAP 20, UITF 19, UITF 21

pUK30.2 For entities that do not apply FRS 26, SSAP 20 applies to foreign exchange transactions. Under SSAP 20:

- ‘Local currency’ is identified rather than ‘functional currency’ but is broadly similar. There is less detailed guidance on determination of local currency in SSAP 20 when compared to the guidance on determination of functional currency under FRS 102.
- The functional currency of a special purpose entity (SPE) is determined by reference to the cash flows of the undertaking itself, with less regard to the functional currency of the parent.
- The profit and loss account of a foreign operation accounted for under the closing rate/net investment method may be translated to the group’s presentation currency at either the actual/average rate or the closing rate.
- Monetary items forming part of a net investment in a foreign operation are treated in the individual accounts of the investor as non-monetary items and not retranslated.
- When foreign currency borrowings have been used to finance or hedge an investment in a foreign operation, in the individual accounts, provided certain criteria are met, the foreign equity investment may be retranslated each period, with the exchange difference recognised through the statement of total recognised gains and losses together with the appropriate proportion of the exchange difference on the borrowings. Under FRS 102 this is only permitted on consolidation.
- When a foreign currency transaction is to be settled at a contracted exchange rate or is covered by a related forward contract, the rate of exchange specified in the trade or forward contract may be used to translate the transaction.
This section applies to transactions in foreign currencies and translation of foreign operations. It also deals with how to translate financial statements into a different presentation currency. Hedge accounting of foreign currency risk is covered in Section 12 Other financial instruments issues.

**Functional currency**

- **30.2** An entity identifies its functional currency as the currency of the primary economic environment in which it operates. This is usually the economic environment in which it primarily generates and expends cash.

- **30.3** Important factors in the identification of functional currency include the currencies that influence sales prices, labour and material costs, and any other costs of providing goods or services. This is often the currency in which sales and costs are denominated and settled. The currency of the country whose regulations and competitive forces determine sales prices is also an important factor.

- **30.4** Secondary factors that may also provide evidence of functional currency are the currency in which financing activities occur, and the currency in which cash received from operating activities is usually retained.

- **30.5** When considering whether the functional currency of a foreign operation (a subsidiary, branch, associate or joint venture) is the same as that of the reporting entity, a number of additional factors are considered: the degree of the operation’s autonomy; the proportion of intercompany transactions compared to the total transaction volume; whether financing needs and cash flows are mainly independent or reliant on the reporting entity; and the extent to which cash flows from the operation’s activities directly affect, and are readily available for remittance to, the reporting entity.

- **30.6** The functional currency of an entity changes only if there has been a change in the underlying nature of the business such that, for example, the currency that influences sales prices has changed.

- **30.7** If the functional currency of an entity changes, all items are translated into the new functional currency at the exchange rate on the date of change and the new functional currency is applied prospectively from that date. The translated amounts for non-monetary items are then treated as their historical cost.

**Reporting foreign currency transactions in the functional currency**

- **30.8** A transaction that requires settlement, or is denominated, in a foreign currency is a foreign currency transaction. Such transactions include the purchase or sale of goods in a foreign currency, borrowing or lending funds in a foreign currency and the acquisition or disposal of assets in a foreign currency.

- **30.9** These transactions are recorded initially in the functional currency by translating the foreign currency amount at the spot exchange rate between the foreign currency and the functional currency at the date of the transaction. The date of the transaction is the earliest date that the transaction qualifies for recognition under FRS 102. An approximation to the spot rate may be used, such as an average rate for a week or month. However, if the exchange rate fluctuates significantly, average rates will not be appropriate.

- **30.10** At each reporting date, foreign currency monetary items are retranslated to the functional currency at the closing rate. A monetary item is a unit of currency held, or asset or liability that will be received or paid in a fixed or determinable number of units of currency. The exchange gain or loss on retranslation or settlement of monetary items is recognised in profit or loss in the period in which it arises. However, if exchange gains or losses arise on monetary items forming part of the entity’s net investment in a foreign operation, they are recognised as set out in paragraph 30.13 of this publication.

- **30.11** Non-monetary items measured at historical cost are translated at the exchange rate at the date of the transaction. Non-monetary items carried at fair value are retranslated at the exchange rate on the date the fair value was determined. When a gain or loss on a non-monetary item is required under FRS 102 to be recognised in other comprehensive income (OCI), the foreign exchange element of the gain or loss is also recognised in OCI. Similarly, when the gain or loss is required to be recognised in profit or loss so is the foreign exchange element of the gain or loss.
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<th><strong>vs EU-IFRS</strong></th>
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<td><strong>Applicable standards:</strong> IAS 21, SIC 7, IFRIC 16</td>
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IFRS30.1 In the consolidated financial statements, exchange differences recognised in OCI that arose on the translation of foreign operations are recycled to profit or loss on disposal of the foreign operation. FRS 102 does not permit or require recycling.
Net investment in a foreign operation

30.12 When a monetary item is receivable from or payable to a foreign operation and settlement is neither planned nor likely to occur in the foreseeable future, this is treated as part of the entity’s net investment in the foreign operation to reflect the substance of the transaction. This may include long-term loans or receivables but will not apply to trade payables or trade receivables. [FRS102.30.12]

30.13 In the financial statements that include the foreign operation and the reporting entity (e.g. on consolidation), the foreign exchange differences on retranslation of such monetary items are recognised in OCI. These exchange differences are not recycled to profit or loss on disposal of the foreign operation. Exchange differences that arise in the individual or separate financial statements on retranslation of monetary items forming part of a net investment in a foreign operation are recognised in profit or loss of the entity or of the foreign operation, as appropriate. [FRS102.30.13] Section 12 provides further guidance on hedge accounting of foreign currency risk.

Use of a presentation currency other than the functional currency

30.14 Financial statements may be presented in any presentation currency. When the functional and presentation currencies differ, the balance sheet and items of income and expense are translated into the presentation currency. [FRS102.30.17]

30.15 If the functional currency is not that of a hyperinflationary economy, the entity translates its assets and liabilities at the closing rate at the reporting date, and all items of income and expense are translated at the exchange rate on the date of the transaction. [FRS102.30.18] For practical reasons, an average rate for the period may be used to translate items of income and expense. However, this will not be appropriate if the exchange rate has fluctuated significantly in the period. All resulting exchange differences are recognised in OCI. [FRS102.30.19]

30.16 The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy are first adjusted using the procedures specified in Section 31 Hyperinflation (and discussed in Chapter 31 of this publication), and then translated into the presentation currency using the same principles as described in paragraph 30.15 above for non-hyperinflationary functional currencies. [FRS102.30.21]

Translation of a foreign operation into the investor’s presentation currency

30.17 When consolidating a foreign operation with a functional currency that differs from the group’s presentation currency, the results and financial position of the foreign operation are translated into the group’s presentation currency as described in paragraph 30.15 of this publication. [FRS102.30.22]

30.18 Normal consolidation procedures apply and intra-group balances and transactions are eliminated. However, the exchange difference arising on an intra-group monetary asset or liability continues to be recognised in profit or loss in the consolidated financial statements, unless it relates to a monetary item forming part of the net investment in a foreign operation, in which case it is recognised in OCI (see paragraph 30.12 of this publication). [FRS102.30.22]

30.19 Goodwill and fair value adjustments arising on acquisition of a foreign operation are treated as assets or liabilities of the foreign operation. They are accounted for in the functional currency of the foreign operation and translated to the presentation currency at the closing rate at each reporting date (see paragraph 30.15 of this publication). [FRS102.30.23]

30.20 When exchange differences arise in relation to a foreign operation that is consolidated but not wholly-owned, the foreign exchange attributable to the non-controlling interest is allocated to the non-controlling interest within the balance sheet. [FRS102.30.20]
31
Hyperinflation
Overview of requirements

- Financial statements of entities with a functional currency of a hyperinflationary economy are stated in terms of the measuring unit at the period end using a general price index.
- Comparatives are restated in terms of the measuring unit current at the reporting date.
vs previous UK GAAP – FRS 26 adopters
Applicable standards: FRS 23, FRS 24

pUK31.1 FRS 26 adopters should refer to the ‘vs EU-IFRS’ section as the requirements of FRS 23 and FRS 24 are identical to those of IAS 21 and IAS 29 respectively. FRS 26 and associated standards are mandatory for entities listed on an EU-regulated market and those applying the fair value accounting rules of the Companies Act.

vs previous UK GAAP – non-FRS 26 adopters
Applicable standards: SSAP 20, UITF 9

pUK31.2 For entities that do not apply FRS 26, the relevant accounting standards are SSAP 20 and UITF 9. In the individual financial statements of a foreign entity in a hyperinflationary economy, previous UK GAAP – unlike FRS 102 – uses the same approach as for non-hyperinflationary entities. Adjustments for inflation are made only for the purpose of consolidating the hyperinflationary entity into the group financial statements. Under UITF 9, adjustments for consolidation purposes may be made either by adjusting the hyperinflationary currency financial statements to reflect current price levels before the consolidation process is undertaken (i.e. by adopting the current purchasing power method that FRS 102 requires at the individual subsidiary stage already), or by using a relatively stable currency as the deemed functional currency for the relevant foreign operations.

vs EU-IFRS
Applicable standards: IAS 21, IAS 29, IFRIC 7

IFRS31.1 The principles in FRS 102 are broadly consistent with IAS 29 but FRS 102 contains less guidance on how to apply these principles.
Section 31

31.1 When the functional currency is that of a hyperinflationary economy, the financial statements are adjusted for the effects of hyperinflation. There is no absolute inflation rate at which an economy is deemed to be hyperinflationary. Instead, an entity considers all possible indicators of hyperinflation, including but not limited to:

- when a population prefers to keep its wealth in non-monetary assets or in a different stable foreign currency;
- credit sales and purchases take inflation into account or are quoted in a different stable foreign currency;
- interest rate, wages and prices are linked to a price index; or
- cumulative inflation over three years is close to or exceeds 100 percent. [FRS102.31.2]

31.2 The financial statements of an entity with a functional currency of a hyperinflationary economy are restated to reflect the measuring unit current at the reporting date both for the current and comparative periods. [FRS102.31.3] Restatement is made by way of a general price index that reflects changes in general purchasing power. [FRS102.31.4]

31.3 The balance sheet is drawn up so that all amounts reflect the measuring unit current at the reporting date. Some balance sheet items, i.e. those carried using a year-end valuation methodology, will already reflect the measuring unit current at the reporting date and so will not require restatement. Other items, i.e. those carried at cost or a version of cost, will require restatement. In summary: [FRS102.31.5]

- Monetary items are not restated as they already reflect the measuring unit current at the reporting date. [FRS102.31.6]
- Non-monetary items carried at fair value or net realisable value are not restated as they already reflect the measuring unit current at the reporting date. [FRS102.31.8]
- All other non-monetary items, carried at historical cost or cost less depreciation and impairment, are restated by applying a general price index from the cost date (or the date the impairment arose) to the reporting period end. The restated amount is reduced if it exceeds its recoverable amount. [FRS102.31.8]
- Assets or liabilities linked by agreement to changes in prices (e.g. index-linked bonds) are presented at the amount as per the agreement. [FRS102.31.7]
- Equity, except retained earnings, is restated using a general price index from the date the contributions were made. [FRS102.31.9]
- Restated retained earnings are derived from the other amounts in the financial statements. [FRS102.31.10]
- All comparative amounts, monetary and non-monetary, are restated in terms of the current period end measuring unit. This is achieved by applying the general price index for the current period to the comparative amounts. [FRS102.31.3]

31.4 Items in the statement of comprehensive income (including the income statement) will also require restatement to reflect the measuring unit current at the end of the reporting period. Therefore, amounts are restated by applying the index from the date of the transaction to the reporting date. An average rate can be used for transactions entered into during the period if general inflation has been even during the period. [FRS102.31.11] Items in the statement of cash flows are restated similarly to reflect the measuring unit current at the reporting period end. [FRS102.31.12] The comparative statement of comprehensive income and statement of cash flows are restated in line with the last bullet point in paragraph 31.3 above.

31.5 Monetary assets lose value during the period. The financial statements will therefore also include in profit or loss a gain or loss on the entity’s net monetary position held during the period, being the loss or gain in purchasing power as a result of the entity holding net monetary assets or monetary liabilities. This gain or loss is offset by any net adjustment to any assets and liabilities linked by agreement to changes in prices. [FRS102.31.13]

31.6 When financial statements no longer need to be prepared on this basis as the economy has ceased to be hyperinflationary, the amounts expressed in the presentation currency at the end of the previous reporting period become the basis for the carrying amount in the subsequent set of financial statements. [FRS102.31.14]
Events after the end of the reporting period
Overview of requirements

- The financial statements are adjusted to reflect events that occur after the end of the reporting period, but before the financial statements are authorised for issue, if those events provide evidence of conditions that existed at the end of the reporting period.

- Financial statements are not adjusted for events that are indicative of conditions that arose after the end of the reporting period, except when the going concern assumption is no longer appropriate.

- Dividends declared after the end of the reporting period are not recognised as a liability in the financial statements but may be presented as a separate component of retained earnings.
**vs previous UK GAAP**

Applicable standard: FRS 21

pUK32.1 The requirements of FRS 21 are identical to those of IAS 10 (see ‘vs EU-IFRS’ section).

**vs EU-IFRS**

Applicable standard: IAS 10

IFRS32.1 IAS 10 provides example scenarios for the process of authorising the financial statements for issue.

IFRS32.2 IAS 10 gives the same examples for adjusting and non-adjusting events as FRS 102 except that it does not include the examples given in paragraphs 32.3(b) and 32.5(a) of this publication.

IFRS32.3 IAS 10 requires the disclosure of dividends declared post period end in the notes to the financial statements.
32.1 Events that happen between the end of the reporting period and the date on which the financial statements are authorised for issue (not of any earlier public announcement) are defined as ‘events after the end of the reporting period’ and can be favourable or unfavourable. These events fall into two categories: [FRS102.32.2]

(a) adjusting events – these provide evidence of conditions that existed at the end of the reporting period; and
(b) non-adjusting events – these are indicative of conditions that arose after the end of the reporting period.

**Adjusting events after the end of the reporting period**

32.2 An entity adjusts its financial statements (amounts and disclosures) after the end of the reporting period for adjusting events. [FRS102.32.4]

32.3 Examples of adjusting events after the end of the reporting period include:

(a) post period end settlement of a court case confirming that a present obligation existed at the period end; [FRS102.32.5(a)]

(b) confirmation of damages receivable for a court case when judgement was reached before the period end but the amount was previously not measurable reliably; [FRS102.32.7(b)]

(c) post period end information indicating that an asset was impaired at the period end (e.g. customer bankruptcy); [FRS102.32.5(b)]

(d) confirmation of the cost or proceeds from the purchase/sale of an asset before the period end; [FRS102.32.5(c)]

(e) confirmation of the amount of profit share or bonus payable in respect of an obligation existing at the period end; [FRS102.32.5(d)] and

(f) detection of fraud or errors indicating the financial statements are incorrect. [FRS102.32.5(e)]

**Non-adjusting events after the end of the reporting period**

32.4 An entity does not adjust the amounts recognised in its financial statements to reflect events after the end of the reporting period that are non-adjusting. [FRS102.32.6] An exception is when events after the end of the reporting period indicate that it is not appropriate for the financial statements to be prepared on a going concern basis. An entity does not prepare its financial statements on a going concern basis if management determines, after the end of the reporting period but before the financial statements are authorised for issue, that it intends or has no alternative other than to liquidate the entity or to stop trading. See paragraph 3.58 of this publication. [FRS102.32.7A,B]

32.5 Examples of non-adjusting events include:

(a) post period end settlement of a court case such that an amount becomes receivable – this would be a contingent asset at the period end, disclosed in accordance with paragraph 21.28 of this publication; and

(b) post period end decline in the market value of investments. [FRS102.32.7]

32.6 For each category of non-adjusting event after the end of the reporting period an entity discloses a description of the event and an approximation of its impact, or a statement that this cannot be estimated. [FRS102.32.10]

32.7 Examples of non-adjusting events that result in disclosure to reflect information that has come to light after the year end but before financial statements’ authorisation include:

- a major business combination or disposal of a major subsidiary;
- announcement of a plan to discontinue an operation;
- major purchases, commitments to purchase, disposals or plans to dispose of assets; and
- tax rate changes that affect tax assets and liabilities (current and deferred) significantly. [FRS102.32.11]

**Dividends**

32.8 Dividends in respect of equity instruments declared post period end are not recognised as a liability since there is no obligation at the period end. The amount may, however, be presented at the period end as a separate part of retained earnings. [FRS102.32.8]
Related party disclosures
Overview of requirements

• Section 33 includes a definition of a party that is related (a related party) to the reporting entity. This may be a person or an entity. A related party transaction is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

• Relationships between a parent and its subsidiaries are disclosed irrespective of whether there have been related party transactions.

• Key management personnel compensation is disclosed in total.

• When related party transactions have occurred, the nature of the related party relationship is disclosed as well as information about the transactions, outstanding balances, and commitments necessary for an understanding of the potential effect of the relationship on the financial statements.

• Transactions between wholly-owned subsidiaries or with their parents within a group need not be disclosed under this section.

• An exemption from the disclosure requirements is given for transactions between entities that are related due to state (government) control, joint control or significant influence, or with their controlling state.
pUK33.1 The definition of related parties is the same under FRS 8 and FRS 102.

pUK33.2 The wording of the exemption from disclosure of transactions between wholly-owned subsidiaries and parents within a group is not identical between FRS 102 and FRS 8. However, it does not seem that this is intended to create a difference in practice since the wording in both cases is derived from the exemption available under the Companies Act.

pUK33.3 FRS 8 exempts from disclosure those emoluments in respect of service as an employee of the reporting entity: disclosure of key management personnel compensation is not required under previous UK GAAP. Although the Companies Act requires disclosure of directors’ remuneration, the definition of key management personnel may be wider than simply the directors of the entity, and the disclosure requirements under the Companies Act are not identical to those of FRS 102.

pUK33.4 Under FRS 8 the name of the related party is disclosed.

pUK33.5 Under FRS 8 there is no exemption for state-controlled entities.
Related party definition

33.1 A person or entity related to the reporting entity is a related party. When considering possible related party relationships, the substance and not merely the legal form of the relationship is assessed.

(a) A person or a close member of that person’s family (see paragraph 33.2 of this publication) 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; or
(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

b) An entity is related to a reporting entity if any of the following conditions apply:

(i) the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);
(ii) one entity is an associate or joint venture (or a subsidiary of the associate or joint venture) of the other entity (or of a member of a group of which the other entity is a member);
(iii) both entities are joint ventures of the same third party;
(iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
(v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity;
(vi) the entity is controlled or jointly controlled by a person identified in (a); or
(vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity). [FRS102.33.2]

33.2 Close members of a person’s family are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity, and include:

(a) that person’s children and spouse or domestic partner;
(b) children of that person’s spouse or domestic partner; and
(c) dependants of that person or of that person’s spouse or domestic partner.

33.3 The following are not necessarily related parties:

(a) entities with a common member of key management personnel or when a member of key management personnel of one entity has significant influence over the other entity;
(b) two investors in a joint venture;
(c) providers of finance, trade unions, public utilities, government departments;
(d) customers, suppliers, franchisors, distributors or agents on which the entity is economically dependent. [FRS102.33.4]

33.4 A related party transaction is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged. [FRS102.33.8] Related party transactions could include purchases, sales, or transfers of goods or services; leases; guarantees; and settlements by the entity on behalf of the related party or vice versa. [FRS102.33.9]
The definition of related parties is the same under IAS 24 and FRS 102.

Generally, the disclosure requirements under FRS 102 are similar to the disclosure requirements included in IAS 24. However, some additional disclosures are required under IAS 24:
- key management personnel compensation is also disclosed by category and type of benefit; and
- only partial exemption is given from the disclosure of relationships and transactions with the state and other state-controlled entities.

Under IAS 24 there is no disclosure exemption for transactions with wholly-owned subsidiaries and parents within a group.
Parent and subsidiary relationships

33.5 Relationships between a parent and its subsidiaries are disclosed irrespective of whether there have been related party transactions. The name of the parent and ultimate controlling party (if different) are disclosed, as well the name of the most senior parent that produces publicly available financial statements (if the parent or the ultimate controlling party does not do so). [FRS102.33.5] See also the Disclosures section below.

Key management personnel compensation

33.6 Key management personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Compensation includes all employee benefits, including share-based payments. Employee benefits include consideration paid in exchange for service rendered to the entity, including consideration paid on the entity’s behalf. [FRS102.33.6] Key management personnel compensation is disclosed in total. [FRS102.33.7] See also the Disclosures section below.

Disclosures

33.7 Qualifying entities (see paragraphs 1.22 to 1.25 of this publication) applying FRS 102 may apply the exemption from the requirement to disclose key management personnel compensation in total. See paragraph 3.7 of this publication.

33.8 Transactions between wholly-owned subsidiaries, or with their parent(s), are exempt from disclosure. [FRS102.33.1A] In the case of transactions between fellow subsidiaries, all subsidiaries that are party to the transaction are required to be wholly-owned by a group that includes the transacting parties in order to be eligible for the exemption.

Examples of the application of this exemption are as follows:

Company A owns 100% of company B, which owns 60% of company C and 100% of company D.

Companies B and D transact with company C. In company B, C and D’s individual accounts the disclosure exemption does not apply since although company B and D are wholly-owned subsidiaries of company A, company C is not wholly-owned by any member of the group.

Company A transacts with company C. In company A and C’s individual accounts the disclosure exemption does not apply since company C is not wholly owned by company A.

Any transactions between companies A, B and D would be exempt from disclosure by all parties.

Suppose now that company D owns the remaining 40% of company C.

Company C is then wholly-owned by the group headed by company A, and the exemption from disclosure of transactions between companies A, B, C and D may be applied in the individual financial statements of each of those companies.
In another example, company H owns 95% of company P, which owns 100% of company X.

Company H transacts with company X. In the individual accounts of companies H and X the disclosure exemption does not apply since although company X is wholly-owned by company P, it is not wholly-owned by the group headed by company H. No disclosure is required in the group accounts of company H as the transactions will eliminate on consolidation.

Company H transacts with company P. The disclosure exemption does not apply since company P is not a wholly-owned subsidiary of company H.

Company P transacts with company X. The disclosure exemption may be applied in the individual financial statements of companies P and X since company X is a wholly-owned subsidiary of company P.

Note that this exemption does not extend to the disclosure of outstanding balances with group undertakings and with undertakings in which the company has a participating interest, both of which are required to be given under the Companies Act formats (that are required to be applied by all entities applying FRS 102). [FRS102.ACA.93]

33.9 When related party transactions have occurred, the nature of the related party relationship is disclosed as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. As a minimum, the following is disclosed:

(a) the amount of the transactions;
(b) the amount of outstanding balances; and:
   (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
   (ii) details of any guarantees given or received;
(c) provisions for uncollectable receivables related to the amount of outstanding balances;
(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties. [FRS102.33.9]

33.10 The disclosures above are made separately for the following categories:

(a) entities with control, joint control or significant influence over the entity;
(b) entities over which the entity has control, joint control or significant influence;
(c) key management personnel of the entity or its parent (in aggregate); and
(d) other related parties. [FRS102.33.10]

33.11 An exemption from the disclosures in paragraph 33.8 of this publication is given in relation to transactions with:

(a) a state (a national, regional or local government) that has control, joint control or significant influence over the reporting entity; and

(b) another entity that is a related party because the same state has control, joint control or significant influence over both the reporting entity and the other entity.

33.12 Parent subsidiary relationships are required to be disclosed.

33.13 It may be stated that related party transactions were made on an arm’s length basis only when such a statement can be substantiated. [FRS102.33.13]

33.14 Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity. [FRS102.33.14]
Specialised activities
Overview of requirements

- This section of the standard includes specific application requirements for certain specialised activities:
  - agriculture – see Chapter 34A of this publication;
  - extractive activities – see Chapter 34B of this publication;
  - service concession arrangements – see Chapter 34C of this publication;
  - financial institutions – see Chapter 34D of this publication;
  - retirement benefit plans: financial statements – see Chapter 34E of this publication;
  - heritage assets – see Chapter 34F of this publication;
  - funding commitments – see Chapter 34G of this publication; and
  - public benefit entities – see Chapters 34H to 34K of this publication.
- A public benefit entity (PBE) is an entity whose primary purpose is for public and social benefit and not to provide a financial return to its shareholders. FRS 102 allows certain departures from normal accounting rules for PBEs. The PBE paragraphs cannot be applied by non-PBEs (Chapter 34H).
- Examples of PBEs are charities, education institutions, local authorities and registered social landlords.
- Non-exchange transactions (Chapter 34I) are those when an entity receives or gives value to another entity without giving or receiving approximately equal value in exchange. The transactions are recognised in income once any performance-related conditions have been met.
- Public benefit entity combinations (Chapter 34J) can be at nil consideration and in substance a gift, or meet the definition of a merger. Other combinations are treated in accordance with Section 19 Business combinations and goodwill.
- Combinations that are in substance a gift generate a gain (or loss) in income and expenditure.
- Mergers meeting specific conditions are accounted for using merger accounting.
- Concessionary loans (Chapter 34K) are loans at below market rate between a public benefit entity and a third party. They are measured initially either at fair value, and subsequently at amortised cost, or at the amount transferred, and subsequently adjusted for accrued interest.
- In certain sectors PBEs will continue to refer to the relevant SORP for more detailed guidance. The Charities SORP, Housing SORP and Higher & Further Education (HEFCE) SORP are being updated to reflect FRS 102.
vs previous UK GAAP
Applicable standards: SSAP 9, FRS 15

pUK34A.1 Under previous UK GAAP there is no standard dealing specifically with biological assets or agricultural produce. The assets are accounted for using the usual rules for fixed or current assets as applicable. Typically, this results in them being recorded at depreciated cost as fixed assets or as stock at the lower of cost and net realisable value.

vs EU-IFRS
Applicable standards: IAS 2, IAS 41

IFRS34A.1 Under IAS 41, biological assets and agricultural produce are measured at fair value less costs to sell. There is no equivalent of the cost model. IAS 41 includes a presumption that the fair value of biological assets can be measured reliably, a presumption that can only be rebutted on initial recognition. Fair value less costs to sell is considered to be the cost of the asset when applying IAS 2.
Agriculture

34A.1 Biological assets are living animals or plants. Agricultural produce is the harvested product of the entity’s biological assets. Agricultural activity is the management by an entity of the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets. [FRS102.GL]

34A.2 A biological asset or an item of agricultural produce is recognised as an asset by an entity when it is controlled by the entity, it is probable that future economic benefits associated with it will flow to the entity, and its fair value or cost can be measured reliably. [FRS102.34.3]

34A.3 An entity engaged in agricultural activity (i.e. one with biological assets) chooses an accounting policy to measure each class of biological asset and its related agricultural produce using either:
   (a) the fair value model; or
   (b) the cost model. [FRS102.34.3A]

34A.4 If an entity chooses the fair value model for a class of assets, it cannot subsequently change to the cost model. If an entity applying the fair value model cannot measure the fair value of an asset reliably, it applies the cost model to that asset until the fair value can be measured reliably. [FRS102.34.6A]

34A.5 Under the fair value model, biological assets are measured on initial recognition and at each balance sheet date at fair value less costs to sell with changes recognised in profit or loss. [FRS102.34.4] When the biological assets are harvested, the fair value of the related agricultural produce at the date of harvest is treated as its cost when applying Section 13 Inventories. In other words, the use of the fair value model for a class of biological asset does not imply that the related agricultural produce will be measured at fair value through profit or loss after harvest.

34A.6 Fair value is determined as follows:
   • If an active market exists for the biological asset or agricultural produce in its current location and condition then its quoted price is its fair value.
   • If more than one active market exists then the fair value is determined by reference to the market that is expected to be used.
   • If an active market does not exist, the entity considers whether recent market transaction prices, market prices for similar assets adjusted for differences, or sector benchmarks can be used to determine a reliable estimate of fair value.
   • If the above are not available then the entity uses the discounted present value of expected net cash flows, so long as this provides a reliable measure of fair value. [FRS102.34.6]

34A.7 Under the cost model, biological assets are measured at cost less any accumulated depreciation and impairment. [FRS102.34.8] At the date of harvest agricultural produce is measured at either: the lower of cost and sale price less costs to sell; or fair value less costs to sell. If fair value is used, any gain or loss arising at the date of harvest is recognised in profit or loss at that time. This is considered to be the cost of the asset when applying Section 13. [FRS102.34.9]
**vs previous UK GAAP**  
*Applicable standard: Oil & Gas SORP*

pUK34B.1 There is no dedicated FRS that deals with exploration or evaluation costs. The Oil Industry Accounting Committee’s Oil & Gas SORP provides guidance on the application of general FRSs to costs incurred on oil and gas exploration, development, production and decommissioning. Its guidance regarding exploration and extraction cost is, in the main, consistent with that subsequently developed under IFRS 6. Production and decommissioning costs are considered under the Oil & Gas SORP.

**vs EU-IFRS**  
*Applicable standards: IFRS 6, IFRIC 20*

IFRS34B.1 There are no GAAP differences that result directly from this section. Where IFRS 6 refers to other IFRSs (and therefore other sections of FRS 102), any GAAP differences are described in that chapter of this publication.
**Extractive activities**

34B.1 An entity engaged in the exploration for and/or evaluation of mineral resources applies IFRS 6 to exploration and evaluation (E&E) expenditure. [FRS102.34.11]

34B.2 Expenditure incurred before a legal right to explore is obtained is not E&E expenditure. Similarly, costs incurred after technical and commercial feasibility are demonstrated, for example, costs incurred on the development or extraction of mineral resources, are not E&E and are accounted for under the sections of FRS 102 relevant to costs of that nature, such as Section 13 Inventories, Section 17 Property, plant and equipment and Section 18 Intangible assets other than goodwill.

34B.3 References within IFRS 6 to other IFRSs are instead generally taken as references to the relevant section of FRS 102. [FRS102.34.11A]

34B.4 Entities apply the Oil & Gas SORP when applicable (e.g. when the accounting is not covered by IFRS 6 or elsewhere within FRS 102), and include a statement to that effect in their financial statements. [FRS100.6] The SORP-making body has indicated that the Oil & Gas SORP will continue to exist but will not be updated. [FRS100.ACA.22]

34B.5 IFRS 6 provides specific extractive industry guidance for the recognition, measurement and disclosure of expenditure.

34B.6 IFRS 6 indicates that normal impairment guidance will apply, although relief is provided from the general requirements in assessing whether there is any indication of impairment for E&E assets. For the purposes of impairment testing, E&E assets are allocated to cash-generating units (CGUs) or to groups of CGUs (although not at a higher level than an operating segment as defined in FRS 102). E&E assets are assessed for impairment, at the pre-determined level, only when facts and circumstances suggest that the carrying amount of an E&E asset may exceed its recoverable amount, and on transfer of E&E assets to development assets.
Previous UK GAAP guidance concentrated on providing guidance on accounting for Private Finance Initiative (PFI) arrangements and did not apply the 'grantor control' scope criteria applied under IFRS. If the arrangements are considered to be PFI arrangements, under Application note F of FRS 5 an entity considers whether the arrangement is akin to a lease and accounted for under the requirements of SSAP 21, or whether it is accounted for directly under FRS 5 Application Note F. If it is accounted for under FRS 5, the entity considers the combined effect of various factors, with greater weight being given to those more likely to occur in practice. This analysis considers who has access to the benefits and exposure to the associated risks of the property and, as a result, who should recognise the property as a fixed asset. This would include an assessment of demand risk, residual value risk, under-performance penalties and other items. If it is concluded that the operator has the risks and rewards then a fixed asset is recorded at cost and then depreciated; if not, the operator recognises a financial asset for the fair value of the property. Grantors would recognise a fixed asset and an obligation if it was concluded that they bore the risks and rewards.

This guidance is applicable to both grantors and operators.
Service concession arrangements

34C.1 A service concession arrangement is an arrangement whereby a public sector body or a public benefit entity (the grantor) contracts with a private sector entity (the operator) to construct (or upgrade), operate and maintain infrastructure assets for a specified period of time (concession period). The operator is paid for its services over the period of the arrangement. A common feature of a service concession arrangement is the public service nature of the obligation undertaken by the operator, whereby the arrangement contractually obliges the operator to provide services to, or on behalf of, the grantor for the benefit of the public. [FRS102.34.12] Infrastructure assets are defined as infrastructure for public services, such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunications networks. [FRS102.GL]

34C.2 An arrangement is within scope when the grantor controls or regulates the services, customers and pricing relating to the use of the infrastructure and controls any significant residual interest in the infrastructure (through ownership, beneficial entitlement or otherwise) at the end of the term of the arrangement. Situations in which the infrastructure asset is expected to have no significant residual value at the end of the term of the arrangement would still meet the requirement of the grantor controlling the residual interest. [FRS102.34.12A]

Accounting by operators

34C.3 Infrastructure assets operated under service concession arrangements are not recognised as property, plant and equipment by the operator because the contractual service arrangement does not convey the right to control the use of the public service assets to the operator. [FRS102.34.12] Arrangements that do not meet the definition of a service concession arrangement would be accounted under normal rules regarding property plant and equipment, leases and revenue. See Sections 17 Property, plant and equipment, 18 Intangible assets other than goodwill, 20 Leases and 23 Revenue respectively. [FRS102.34.12D]

34C.4 The accounting by the operator for the consideration receivable on construction services depends on the nature of the arrangement. There are two categories of service concession arrangement, under which the operator receives:

(a) a financial asset – an unconditional contractual right to receive a specified or determinable amount from, or at the direction of, the grantor in return for constructing (or upgrading) the infrastructure asset and then operating and maintaining it for a specified period. This would include scenarios when the grantor guarantees any shortfall between amounts received from users and a pre-determined target; and/or

(b) an intangible asset – a right to charge for use of the infrastructure asset that it constructs or upgrades, and then operates and maintains, for a specified period. The amounts received will depend on the extent to which the public uses the service. [FRS102.34.13]

34C.5 A single contract may include both types of arrangement, which would result in both a financial asset and an intangible asset being recognised. [FRS102.34.13]

34C.6 Financial assets and intangible assets relating to the construction services provided under the service concession arrangement are measured initially at fair value with the fair value being based on the fair value of the construction (or upgrade) services provided. The entity subsequently accounts for these assets in accordance with Section 11 Basic financial instruments and Section 12 Other financial instrument issues for financial assets [FRS102.34.14] and Section 18 for intangible assets. [FRS102.34.15]

34C.7 The operator applies Section 23 to the revenue it receives for the operating services it performs under the service concession arrangement. [FRS102.34.16]

34C.8 Borrowing costs incurred as part of the arrangement will normally be expensed in the period they are incurred. However, in a construction phase when an intangible asset is recognised, the borrowing costs are capitalised if a policy of capitalisation has been adopted. [FRS102.34.16A]
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<th><strong>vs EU-IFRS</strong></th>
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IFRS34C.1 IFRIC 12 includes more detailed guidance and requirements specific to service concession arrangements.

IFRS34C.2 IFRIC 12 applies directly to public-to-private service concession arrangements although it does not define ‘public sector’ or ‘private sector’ and as such a wide variety of arrangements could fall within the scope of IFRIC 12 if the other scope requirements are met. Under FRS 102, the grantor is defined as a public sector body or a public benefit entity and the operator is defined as a private sector entity.

IFRS34C.3 IFRIC 12 specifies that the operator shall account for revenue and costs relating to construction or upgrade services in accordance with IAS 11. No similar guidance is provided under FRS 102 as to whether revenue should be recognised for the construction or upgrade services provided; rather it merely indicates that the financial asset or intangible asset recognised will be measured initially at fair value with the fair value being based on the fair value of the construction (or upgrade) services provided.

IFRS34C.4 IFRIC 12 deals only with the accounting by operators and not grantors. A grantor would need to consider how to apply the general principles of IFRSs to the specific contractual arrangement it had with the operator.
**Accounting by grantors**

34C.9 For service concession arrangements the grantor recognises the infrastructure as an asset, together with a liability for its obligation under the service concession arrangement. [FRS102.34.12E]

34C.10 The grantor uses the finance lease liability model to recognise the asset and associated liability. In accordance with that guidance, an asset and liability equal to the present value of the minimum lease payments are recognised. Here, that would result in an asset and liability equal to the present value of the unconditional payments required to be made to the operator under the service concession arrangement. [FRS102.34.12F] No asset or liability is recognised for contingent payments to the operator, including scenarios when the payments are based on the level of usage of the infrastructure.

34C.11 Subsequently the liability is accounted for in accordance with finance lease liability guidance (see Section 20) and the asset will be accounted for as property, plant and equipment or an intangible asset (see Section 17 or Section 18). [FRS102.34.12G-H] Contingent payments relating to the infrastructure are expensed as incurred.
vs previous UK GAAP – FRS 26 adopters
Applicable standards: FRS 1, FRS 26, FRS 29

pUK34D.1 If an entity had adopted FRS 26 and hence applied FRS 29, the disclosure requirements for financial instruments and capital are the same as under IFRS, see the ‘vs EU-IFRS’ section. However, FRS 26 provides a scope exemption for subsidiary undertakings (other than banks or insurance companies) for which 90 percent or more of the voting rights are controlled within the group, provided the entity is included in publicly available consolidated financial statements that include the disclosures required by FRS 26. There is no similar exemption in FRS 102. FRS 26 and associated standards are mandatory for entities listed on an EU-regulated market and those applying the fair value accounting rules of the Companies Act.

vs previous UK GAAP – non-FRS 26 adopters
Applicable standards: FRS 1, FRS 13

pUK34D.2 Many (but not all) of the financial institutions defined by FRS 102 that did not previously adopt FRS 26 would have been required to provide the disclosures of FRS 13 Part B (banks and similar institutions) or Part C (financial institutions other than banks). The disclosures required by FRS 13 Parts B and C differ from FRS 102 in a number of respects, e.g. FRS 13 required more detailed analysis of interest rate and currency risk exposure but had no specific disclosure requirements in respect of credit risk.

pUK34D.3 If the entity had not adopted FRS 26 it would not be required to make the capital disclosures outlined in FRS 29, although the Companies Act would require some disclosures.

vs EU-IFRS
Applicable standards: IAS 1, IAS 7, IFRS 7

IFRS34D.1 Equivalent requirements are included in IAS 1 for capital disclosures; IAS 7 for reporting of cash flows on a net basis; and IFRS 7 for the remainder of the financial instruments disclosures. The main difference is that IFRS 7 has more extensive disclosure requirements including, for example, details of reclassification of financial instruments between categories, summary quantitative data about risk exposures based on internal information provided to senior management, more detailed credit risk disclosures and details of any transfers of financial assets.
Financial institutions

34D.1 See paragraph 1.32 of this publication for the definition of a financial institution and paragraphs 3.6 to 3.8 for the disclosure exemptions available to these entities. See also Section 11 Basic financial instruments and Section 12 Other financial instrument issues for the financial instruments disclosure requirements.

34D.2 The individual financial statements of a financial institution that is not a retirement benefit plan give the disclosures listed in paragraphs 34D.4 to 34D.5 of this publication. For retirement benefit plans see paragraphs 34E.1 to 34E.11 of this publication. [FRS102.34.17(a), FRS102.34.18]

34D.3 If a group contains a financial institution that is not a retirement benefit plan and financial instruments held by the financial institution are material at group level, then the consolidated financial statements give the disclosures listed in paragraphs 34D.4 to 34D.5 of this publication for those financial instruments. The principal activity of the group does not affect this disclosure requirement. [FRS102.34.17(b)]

34D.4 In addition to the disclosure requirements in Sections 11 and 12, a financial institution discloses the following information:

(a) an explanation of the significance of financial instruments to the entity’s financial statements, including a disaggregation of the relevant balance sheet captions by class of financial instrument, so as to display the nature and characteristics of those financial instruments; [FRS102.34.19]

(b) a reconciliation, by financial asset class, of any separate impairment allowance accounts; [FRS102.34.21]

(c) an analysis by class according to the three-tier hierarchy of financial instruments carried at fair value (see paragraph 11.25 of this publication); [FRS102.34.22]

(d) an analysis of the credit, liquidity and market risks that the entity is exposed to at the end of the reporting period, including for each type of risk, how these risks arise, how the entity manages and measures these risks and any changes in how the risks arise or their management and measurement methods from the previous period; [FRS102.34.23]

(e) for each class of financial instrument, an entity’s maximum exposure to credit risk (when this is different from the carrying amount of the financial instrument), any collateral or credit derivatives that mitigate credit risk, details of credit quality of financial assets that are neither past due nor impaired, a maturity analysis of financial assets that are past due but not impaired and those that are impaired and an analysis of financial assets that are individually considered to be impaired (including the factors considered in the impairment assessment); [FRS102.34.25-26]

(f) for any assets recognised as a result of an entity taking possession of collateral, the nature and amount of these assets and how the entity plans to dispose of or use them; [FRS102.34.27]

(g) a maturity analysis for financial liabilities showing the remaining contractual undiscounted amounts of derivative and non-derivative financial liabilities; [FRS102.34.28] and

(h) a sensitivity analysis for each market rate risk (e.g. risks from interest, currency rates and other price risk), their effect on profit or loss and equity. The methods and the assumptions used in making this analysis are also disclosed. [FRS102.34.29] If the entity manages financial risks using a model that reflects interdependencies between risk variables (e.g. a value-at-risk approach), that data may be disclosed instead of the sensitivity analysis. [FRS102.34.30]

34D.5 The entity also discloses its objectives, policies and processes for managing capital, based on the information provided internally to key management personnel. This includes qualitative and quantitative data about what the entity manages as capital, as well as information about externally imposed capital requirements. [FRS102.34.31] If providing these disclosures on an aggregate basis would not provide useful information due to the different capital requirements across the entity, then separate information is provided. [FRS102.34.32]

34D.6 If it is required to present a statement of cash flows, a financial institution may include the following cash flows on a net basis:

- cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
- the placement of deposits with and withdrawal of deposits from other financial institutions; and
- cash advances and loans made to customers and the repayment of those advances and loans. [FRS102.34.33]
Financial statements of retirement benefit plans prepared under previous UK GAAP apply the *Financial reports of pension schemes* SORP (May 2007) (Pensions SORP).

Under the Pensions SORP there is an option, for certain insurance policy assets, to hold these assets at nil.

Under the Pensions SORP only *investment* assets (and not operating assets or liabilities) are held at fair value.

Previous UK GAAP requires consolidated accounts to be prepared if the plan has subsidiaries.

FRS 102 requires more disclosures than the Pensions SORP, particularly for financial instruments.
Retirement benefit plans: Financial statements

34E.1 Retirement benefit plans include defined contribution (DC) plans, defined benefit (DB) plans and plans with both DC and DB elements. When a plan has both DC and DB sections, it differentiates between these in its financial statements (if material). [FRS102.34.34]

34E.2 A DC plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. DB plans are all retirement benefit plans that are not DC plans. [FRS102.GL]

34E.3 A retirement benefit plan does not need to comply with the FRS 102 definition of a complete set of financial statements (see paragraph 3.64 of this publication). [FRS102.34.35] It is exempt from Section 7 Statement of cash flows and so does not present a cash flow statement. [FRS102.7.1A] A retirement benefit plan refers to the Pensions SORP (updated to reflect FRS 102) for further guidance.

34E.4 The financial statements of retirement benefit plans include:
(a) a fund account that presents changes in net assets available for benefits, including fair value changes;
(b) a net assets statement that presents net assets available for benefits; and
(c) notes that contain significant accounting policies and explanatory information. [FRS102.34.35]

34E.5 The fund account of a DB or DC plan presents:
(a) employer contributions;
(b) employee contributions;
(c) investment income such as interest and dividends;
(d) other income;
(e) benefits paid or payable (analysed, for example, as retirement, death and disability benefits, and lump sum payments);
(f) administrative expenses;
(g) other expenses;
(h) taxes on income;
(i) profits and losses on disposal of investments and changes in value of investments; and
(j) transfers from and to other plans. [FRS102.34.37]

34E.6 The net assets statement of a DB or DC plan presents its net assets available for benefits, being its:
(a) assets at the period end classified appropriately; less
(b) liabilities at the period end excluding the actuarial value of future retirement benefits.

34E.7 The approach to valuing the plan’s assets is explained in the notes. [FRS102.34.38]

34E.8 The net assets available for benefits are measured at fair value, with the exception of certain insurance policies (see paragraph 28.20 of this publication). [FRS102.28.15, FRS102.34.36]

34E.9 When the asset is an insurance policy that exactly matches both the amount and timing of some or all of the benefits payable by the plan, the fair value of the asset is deemed to be the present value of the related benefit liability. [FRS102.34.36]

34E.10 No exception is made from the requirement to carry plan assets at fair value for investments in any subsidiaries, associates or joint ventures. Therefore, a retirement benefit plan does not prepare consolidated financial statements.
vs EU-IFRS
Applicable standard: IAS 26

IFRS34E.1 IAS 26 permits actuarial liabilities to be either:

- recognised in the net assets statement;
- disclosed in the notes to the financial statements; or
- disclosed in a separate report alongside the financial statements (as in FRS 102).

IFRS34E.2 Under IAS 26 only investment assets are held at fair value. Other assets and liabilities are accounted for under the relevant IFRS.

IFRS34E.3 There are no disclosure exemptions available from IFRS 7.
34E.11 When a plan holds assets at fair value that are not financial instruments, it follows the disclosure requirements of the relevant section of FRS 102, e.g. for investment properties, paragraph FRS 102.16.10. [FRS102.34.39]

34E.12 A retirement benefit plan is classified as a financial institution but does not give all the disclosures required by FRS 102.34.19 to FRS 102.34.33 (see Chapter 34D of this publication). [FRS102.34.17] The disclosures required are listed in FRS 102.34.40-46 and include:

- financial instruments are disaggregated by class for the purpose of disclosure to enable users to evaluate the performance and position of the financial instruments;
- when financial instruments are held at fair value, their hierarchy is disclosed (see paragraphs 11.25 to 11.27 of this publication);
- the nature and extent of credit risk and market risk.

34E.13 There is no requirement for a DB plan to recognise an actuarial liability for future retirement benefits. [FRS102.34.47]

34E.14 A DB plan presents an additional report attached to the financial statements showing:

- the actuarial present value of future retirement benefits as per the latest plan valuation;
- the date of the latest plan valuation; and
- the method and significant assumptions used by the actuary in that valuation. [FRS102.34.48]
Cutting through UK GAAP

Applicable standard: FRS 30

pUK34F.1 The definition of a heritage asset under FRS 102 includes intangible assets. Under FRS 30 the definition is restricted to tangible assets.

pUK34F.2 Heritage assets generally are accounted for in the same way under FRS 102 and FRS 30, although differences can arise in relation to the recognition of revaluation losses (see Chapter 17 of this publication).

pUK34F.3 Under FRS 30 donated heritage assets are recognised initially at valuation unless (exceptionally) it is not practicable to do so. This is not specifically covered in Section 34 but under paragraph FRS 102.17.14, an asset acquired in an exchange transaction is measured at fair value and FRS 102.PBE34.71 requires that a donated asset is recognised at fair value. However, the use of fair value under FRS 102 may not always be consistent with the approach under FRS 30 as FRS 30 does not require fair value to be used and permits the use of any appropriate and relevant valuation method.

Applicable standards: IAS 16, IAS 38, IAS 40

IFRS34F.1 There is no concept of heritage assets under IFRS. Such assets would be accounted for under IAS 16, IAS 38 or IAS 40.
Heritage assets

34F.1 Heritage assets are tangible and intangible assets with historic, artistic, scientific, technological, geophysical, or environmental qualities held and maintained principally for their contribution to knowledge and culture. [FRS102.GL] When historic assets or works of art are not maintained principally for their contribution to knowledge and culture, they are not heritage assets and either Section 16 Investment property, Section 17 Property, plant and equipment or Section 18 Intangible assets other than goodwill applies as appropriate. For example, historic buildings used as offices are not heritage assets although entities may consider it appropriate to give the related heritage asset disclosures for such assets. [FRS102.34.49-50]

34F.2 An entity applies Section 17 in accounting for heritage assets, including its policy choice of the cost or revaluation models, except that:

- heritage assets are disclosed separately in the balance sheet from other assets; [FRS102.34.52]
- when information on the cost or value of an asset is not available, and cannot be obtained at a cost commensurate with the benefit to users of the financial statements, it is not recognised in the balance sheet but appropriate disclosures are instead included in the notes; [FRS102.34.53]
- Section 27 Impairment of assets is applied at each balance sheet date to determine whether a heritage asset is impaired. [FRS102.34.54]

34F.3 Paragraphs FRS 102.34.55-56 of the standard list the disclosure requirements for those heritage assets that are recognised in the balance sheet and for those that are not. Such disclosures include information on the nature and scale of heritage assets held by the entity, as well as a summary of the acquisitions, donations and disposals of heritage assets for the current period and previous four periods.
**vs previous UK GAAP**

Applicable standards: FRS 12, Charities SORP

pUK34G.1 There is no specific guidance on funding commitments in the accounting standards, Housing SORP or HEFCE SORP under previous UK GAAP. Commitments would be accounted for when they meet the definition of a liability under FRS 12.

pUK34G.2 The Charities SORP includes specific guidance on funding commitments, similar to that provided by FRS 102.

**vs EU-IFRS**

Applicable standard: IAS 37

IFRS34G.1 There is no specific guidance on funding commitments under IFRS. Commitments would be accounted for when they meet the definition of a liability.
Funding commitments

34G.1 Commitments to fund another party by making a loan to that party are not in the scope of this section and are covered by Section 11 Basic financial instruments or Section 12 Other financial instruments issues. [FRS102.34.57] This section deals, for example, with commitments to give grants or similar financial support to or by a charity. Its application is, however, wider than just public benefit entities.

34G.2 An entity recognises a liability and, usually, the related expense for a commitment to fund (other than with loans) another party when:

- the definition and recognition criteria for a liability are met (see paragraph 3.31 of this publication);
- the entity cannot reasonably withdraw from the obligation (legal or constructive); and
- there are no performance-related conditions to be satisfied before the other party is entitled to the funding. [FRS102.34.59]

34G.3 The expectation of funding another entity is not sufficient for liability recognition, e.g. a general statement that funding will be given to a certain class of beneficiaries. For a liability to be recognised the grantor will have raised a valid expectation in the recipient from which it cannot realistically withdraw, i.e. it will have communicated details of the funding to the recipient. A liability is not recognised when the promise to fund is conditional on the receipt of funds from another party. [FRS102.34A.2]

34G.4 When there are performance-related conditions, the liability is recognised once these are met. [FRS102.34.60] If a condition is merely administrative (e.g. submission of their annual report) then this is not a performance-related condition. [FRS102.34A.5]

34G.5 The liability is recognised at the present value of the committed resources. [FRS102.34.58] When a liability is not recognised for a funding commitment, disclosure of the details of this commitment are made. [FRS102.34A.6]

34G.6 Appendix A to Section 34, which is an integral part of the standard, provides further guidance on funding commitments.
**vs previous UK GAAP**

Applicable standards: Charities SORP, HEFCE SORP, Housing SORP

pUK34H.1 There is no general concept of PBEs under previous UK GAAP. Similarly to FRS 102, if an entity is within the scope of a SORP then it applies that SORP.

**vs EU-IFRS**

Applicable standard: IAS 37

IFRS34H.1 There is no general concept of PBEs under IFRS. EU-IFRSs apply equally to PBEs.
Public benefit entities: Scope

34H.1 A public benefit entity (PBE) is an entity whose primary objective is to provide goods or services for the general public, community or social benefit and for which any equity is provided with a view to supporting the entity’s primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members. A PBE group includes a PBE parent and all of its wholly-owned subsidiaries. [FRS102.GL]

34H.2 A PBE may benefit a particular section of the public rather than society as a whole; however, its primary purpose is not to bring return to its investors. Mutual insurance companies and co-operatives that pay dividends are therefore not PBEs. Equity investors in PBEs have contributed to the entity to support the provision of goods or services to beneficiaries and not for financial return. [FRS102.GL]

34H.3 Paragraphs in FRS 102 prefixed by ‘PBE’ apply solely to public benefit entities. These paragraphs are not applicable (whether directly or by analogy) to entities that are not PBEs. [FRS102.1.2] Most are in Section 34 Specialised activities but a small number, and certain other specific references to PBEs, appear elsewhere, as follows:

- Section 11 Basic financial instruments [FRS102.PBE11.1A] and Section 12 Other financial instruments issues [FRS102.PBE12.1A] refer users to Section 34 for details of how to account for concessionary loans (see Chapter 34K of this publication).
- Section 13 Inventories [FRS102.13.5A] requires inventory acquired by PBEs through non-exchange transactions to be recognised initially at fair value only when it is practicable to recognise incoming resources (see paragraph 34I.6 of this publication).
- Section 16 Investment property [FRS102.16.3A] requires property held for the provision of social benefit to be accounted for as property, plant and equipment and not as investment property (see Chapter 17 of this publication).
- Section 19 Business combinations and goodwill [FRS102.PBE19.2A] refers users to Section 34 for the accounting for PBE combinations (see Chapter 34J of this publication).

34H.4 Other than as directed by the paragraphs listed above, all other requirements of FRS 102 are applicable to PBEs. This includes requirements on funding commitments (see Chapter 34G of this publication).

34H.5 Early adoption of FRS 102 is permitted only if there is no conflict with any relevant SORP. This requirement is particularly relevant to PBEs as many apply the Charities SORP, HEFCE SORP or Housing SORP. [FRS102.1.14]

34H.6 The financial statements of a PBE that applies ‘PBE’ paragraphs include an explicit statement that the entity is a public benefit entity. [FRS102.PBE3.3A]
**vs previous UK GAAP**

Applicable standards: FRS 5, Charities SORP, HEFCE SORP, Housing SORP

pUK34I.1 Accounting standards contain no specific guidance on non-exchange transactions or donated goods and FRS 5 would apply. The pre-FRS 102 PBE SORPs include guidance as follows:

pUK34I.2 The Charities SORP includes accounting requirements for donations of cash, goods and services and legacies. Incoming resources are recognised when entitlement, certainty and measurement criteria are met. Gifts in kind are recognised at their value to the charity.

pUK34I.3 Under the HEFCE SORP, charitable donations are recognised when received or before receipt if it is sufficiently certain the donation will be received and the value can be measured reliably. If donations are for restricted purposes they are recognised on the balance sheet as endowment funds. If the donation is for the purchase or construction of a fixed asset, it is recognised as a deferred capital grant. When performance conditions are fulfilled over time, an accruals method of recognition is adopted.

pUK34I.4 Under the Housing SORP a gift is measured at current value and recognised in turnover when the donation is from a non-public body.

**vs EU-IFRS**

Applicable standards: IAS 20, IFRIC 12, IFRIC 18

IFRS34I.1 There is no specific guidance under IFRS on assets or resources received by not-for-profit entities from third parties for no consideration. With the exception of assets or resources transferred to an entity by a government via government grant (IAS 20), or arrangements within the scope of IFRIC 18 or IFRIC 12, there is also no guidance on such receipts by other entities. Guidance on accounting for these arrangements by not-for-profit entities may be obtained from IAS 20. This provides a choice of accounting policy to measure the assets or resources either at their fair value or at the nominal amount paid, and to recognise them to reflect the existence of any related conditions.
Public benefit entities: Incoming resources from non-exchange transactions

34I.1 A non-exchange transaction is a transaction whereby an entity receives value from (or gives value to) another entity without directly giving (or receiving) approximately equal value in exchange. [FRS102.PBE34.65]

34I.2 Examples of non-exchange transactions are donations (of cash, goods and services) and legacies. FRS102.PBE34.67 The accounting for government grants, which are similar in many ways, is covered by Section 24 Government grants. FRS102.PBE34.64 Government grants may be accounted for either under a performance model or an accrual model but only the former is available for other non-exchange transactions for PBEs.

34I.3 When they can be measured reliably, receipts of resources from non-exchange transactions by PBEs or entities in PBE groups are recognised at fair value:

- in income when received or receivable, when there are no future performance-related conditions;
- in income when performance-related conditions are met; or
- as a liability when resources are received before the revenue is recognised. [FRS102.PBE34.67]

34I.4 For example, for income from legacies, the recognition criteria are normally met following probate. If notification of the legacy payment is received post year end but the executors had agreed pre-year end that there are sufficient estate funds to pay the legacy, then the legacy is accrued in the financial statements. PBEs with many immaterial legacies may take a portfolio approach. [FRS102.PBE34B.5-7]

34I.5 When there are no performance-related conditions, income is recognised immediately rather than being spread over any expected period of benefit, i.e. there is no ‘accrual’ model.

34I.6 If it is impracticable to estimate the value of resources received or receivable sufficiently reliably (or the costs of valuation outweigh the benefits), then income is recognised when the resources are sold. [FRS102.PBE34.69-70]

34I.7 For example, high volume, low value second-hand goods donated for resale are recognised as income in the period in which they are sold. [FRS102.PBE34B.4]

34I.8 When repayment becomes probable due to non-compliance with restrictions or performance-related conditions, the entity recognises a liability. [FRS102.PBE34.71]

34I.9 Donations of services that can be reasonably quantified are recognised as both income and expense, or capitalised when the services are used in the production of an asset. [FRS102.PBE34.72, FRS102.34B.8-9] However, as the standard expects that contributions made by volunteers cannot be reasonably quantified, these services are not recognised. It appears, therefore, that there is no option to recognise volunteer services as income and expense, but the benefit is disclosed in the financial statements. [FRS102.PBE34B.11-12]

34I.10 Income from non-exchange transactions is measured at:

- the value to the entity, when the donated services or facilities would otherwise have been purchased, i.e. estimated price paid by the entity in an open market for an equivalent service or facility; or
- fair value, for all other income from non-exchange transactions, i.e. open market value. [FRS102.PBE34.73, FRS102.PBE34B.15-16]

34I.11 When open market value cannot be determined, other sources such as cost to the donor or estimated resale value less costs to sell may be used to calculate a value. [FRS102.PBE34B.17]

34I.12 Non-exchange transactions may include a number of conditions or requirements but it is only those meeting the definition of performance-related conditions that may require deferral of recognition of the incoming resource as income.

34I.13 A performance-related condition is a condition that requires the performance of a particular level of service or units of output to be delivered, with payment of, or entitlement to, the resources conditional on that performance. [FRS102.GL] Judgement may be required in establishing whether conditions are fulfilled over a period or only once all conditions are fulfilled. Appendix B to Section 34 acknowledges that some requirements are stated so broadly that they do not actually impose a performance-related condition. [FRS102.PBE34B.14] An example of such an administrative type requirement might be an obligation on a charity that receives a donation to supply a copy of its annual accounts when they are available.

34I.14 The existence of a restriction does not prohibit a resource from being recognised in income when receivable. [FRS102.PBE34.68] A restriction limits or directs the purposes for which a resource may be used but the requirement does not meet the definition of a performance-related condition. [FRS102.GL] When repayment does become probable as a result of a failure to meet a restriction, then a liability is recognised. [FRS102.PBE34.71]
vs previous UK GAAP
Applicable standards: FRS 6, Charities SORP, HEFCE SORP, Housing SORP

pUK34J.1 Under FRS 6, merger accounting is permitted providing certain conditions are met. These criteria include those of FRS 102 but also criteria on the form of consideration given, the relative sizes of the combining entities and the retention of a material interest in the future performance of only part of the combined business.

pUK34J.2 There is no specific guidance under accounting standards on business combinations for nil consideration; the general requirements of FRS 6 would result in negative goodwill being recognised on the balance sheet. However, the PBE SORPs do include guidance in this area.

pUK34J.3 The Charities SORP, states that merger accounting is applicable for charities when two or more charities merge. This applies despite two of the five criteria referring to shareholders’ funds (and hence not applicable for charities). Merger accounting also applies for business combinations with nil consideration (i.e. a gift), with the balancing credit/debit recognised as income/expense. Charities cannot merge with non-charitable companies; acquisition accounting would apply when such companies are acquired.

pUK34J.4 Under the HEFCE SORP, merger accounting is applied when the FRS 6 criteria (excluding the two relating to shareholders’ funds) are met. When the criteria are not met, acquisition accounting is applied. Goodwill is recognised for the difference between consideration paid and net assets acquired. There is no guidance for business combinations with nil consideration.

pUK34J.5 Under the Housing SORP, there are three applicable accounting treatments for business combinations involving two or more social landlords: merger accounting; acquisition accounting for commercial transactions; and accounting for non-exchange transactions, which is a form of acquisition accounting to be used when, in substance, one business has been gifted to another. It is expected that most business combinations failing to meet the FRS 6 criteria for merger accounting are accounted for as non-exchange transactions since there is rarely any purchase consideration. For non-exchange transactions, the fair value of the recognised assets and liabilities gifted is recognised as a gain or loss in the income and expenditure account in the year of the transaction.

vs EU-IFRS
Applicable standard: IFRS 3

IFRS34J.1 Under IFRS, common control transactions may be accounted for at book value. This is similar to merger accounting but there are differences, e.g. prior year comparatives are not required to be restated for the combined entities. Combinations between unrelated organisations are accounted for as acquisitions under IFRS 3.

IFRS34J.2 IFRS 3.43 states that when a business combination is achieved without the transfer of consideration, the acquisition method is applied. The acquirer uses the acquisition date fair value of its interest in the acquiree, determined using a valuation technique, instead of the acquisition date fair value of the consideration transferred to determine the amount of goodwill. Any gain on a bargain purchase is recognised in profit or loss.
Public benefit entities: Entity combinations

34.1 This section is applicable for public benefit entities when entity combinations:

(a) are at nil or close to nil and are in substance a gift and not a fair value exchange; or
(b) are a merger. [FRS102.PBE34.75]

34.2 Other combinations that are not in substance a gift or do not meet the definition of a merger are accounted for in line with Section 19 Business combinations and goodwill. [FRS102.PBE34.76, FRS102.PBE34.81]

34.3 Combinations that are in substance a gift are accounted for in line with Section 19 [FRS102.PBE34.77] except that:

(a) a gain is recognised in income for any excess of the fair value of the assets received over the fair value of the liabilities assumed; [FRS102.PBE34.78] and
(b) a loss is recognised in expenses for any excess of the fair value of the liabilities assumed over the fair value of the assets received. [FRS102.PBE34.79]

34.4 This means that all identifiable assets and liabilities acquired are included at fair value but there will be no goodwill or negative goodwill.

34.5 Combinations are a merger when a new reporting entity is created from the combining entities in which controlling parties of the combining entities come together in a partnership for the mutual sharing of risks and benefits of the newly formed entity and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant. [FRS102.GL]

34.6 Mergers are required to meet all of the following criteria in order to be accounted for using merger accounting:

- no party is depicted as the acquirer or acquiree by any party to the combination;
- the beneficiaries of the combining entities and the purpose of the benefits provided do not change significantly as a result of the combination; and
- all parties are involved in the development of the management structure of the new combined entity, which is based on consensus rather than voting rights. [FRS102.GL]

34.7 Under merger accounting:

- there are no fair value adjustments to the carrying values of the entities’ assets and liabilities; [FRS102.PBE34.82]
- adjustments are made to align accounting policies when these differ; [FRS102.PBE34.82]
- the results and cash flows of the merging entities are combined from the start of the financial period in which the merger occurred; [FRS102.PBE34.83]
- the comparatives are restated as ‘combined’ figures, incorporating the results for all merging entities for the previous accounting period; [FRS102.PBE34.84]
- any merger costs are charged to income and expenditure when they are incurred. [FRS102.PBE34.85]
**vs previous UK GAAP – FRS 26 adopters**
Applicable standard: FRS 26

pUK34K.1 For entities applying FRS 26, see the ‘vs EU-IFRS’ section.

**vs previous UK GAAP – non-FRS 26 adopters**
Applicable standard: FRS 4

pUK34K.2 Non-FRS 26 entities recognise loans at amortised cost. There is no specific guidance or requirements on concessionary loans under previous UK GAAP or in the PBE SORPs.

**vs EU-IFRS**
Applicable standard: IAS 39

IFRS34K.1 Loans at below market rate are accounted for under the recognition and measurement criteria of IAS 39, i.e. initial measurement at fair value and subsequent measurement at amortised cost. Any immediate gain on recognition would be taken as income (in effect a donation). Loans repayable on demand will not have a fair value less than the face value of the loan. When a parent entity grants a loan at below market rate of interest to its subsidiary, the benefit is accounted for as a capital contribution and recognised in equity.
Public benefit entities: Concessionary loans

34K.1 This section is applicable for PBEs or entities within a PBE group with concessionary loan arrangements only: it does not apply to market rate loans or other commercial arrangements. [FRS102.PBE34.87] For example, PBEs have a choice as to whether to recognise an interest free loan initially at fair value or its face value.

34K.2 Concessionary loans are those made or received between a PBE or an entity within the PBE group, and a third party at below the prevailing market rate of interest that are not repayable on demand and are to further the objectives of the PBE or PBE parent. [FRS102.PBE34.88]

34K.3 Concessionary loans made and received are accounted for either:

- initially at fair value and subsequently at amortised cost in accordance with Section 11 Basic financial instruments; [FRS102.PBE34.89] or
- initially at the amount paid or received [FRS102.PBE34.90] and subsequently adjusted for accrued interest payable or receivable. [FRS102.PBE34.91] Any irrecoverable element of a loan is recognised as an impairment in income and expenditure. [FRS102.PBE34.92]

34K.4 The chosen policy is applied consistently to all concessionary loans both made and received. [FRS102.PBE34.89] Disclosure of concessionary loan details is required.
Transition to FRS 102
Overview of requirements

- This section details the transitional requirements and exemptions available for the first FRS 102 financial statements that a first-time adopter prepares.
- The date of transition is the first day of the earliest comparative period for which the entity presents its financial statements under FRS 102.
- FRS 102 is applied retrospectively except for derecognition of financial assets and liabilities, hedge accounting, accounting estimates, discontinued operations and non-controlling interests.
- There are first-time adoption exemptions available, including for business combinations, dormant companies and the deemed cost of revalued assets.
There are no requirements or exemptions, and no guidance, on first-time adoption of, or transition to, previous UK GAAP. An entity applying previous UK GAAP for the first time would therefore need to apply all previous UK GAAP requirements retrospectively for any transactions or balances in the financial statements at the date of transition, except to the extent that the standard in question applied prospectively from a specific date.
35.1 This section applies to the first financial statements of a first-time adopter of FRS 102, regardless of its previous accounting framework. [FRS102.35.1]

35.2 The first financial statements under FRS 102 are the first financial statements including an explicit and unreserved statement of compliance with FRS 102, when previous financial statements were not prepared under FRS 102, e.g. those financial statements were prepared in accordance with previous UK GAAP or EU-IFRS. [FRS102.35.4]

35.3 The date of transition to FRS 102 is the beginning of the earliest period for which the entity presents full comparative information in accordance with FRS 102 in its first set of FRS 102 financial statements. For example, if an entity’s first financial statements prepared under FRS 102 are for the year ended 31 December 2015, with comparatives shown under FRS 102 for the year ended 31 December 2014, then the entity’s date of transition to FRS 102 is 1 January 2014. [FRS102.35.6]

35.4 When an entity has previously applied FRS 102 but did not include an explicit and unreserved statement of compliance with FRS 102 in its most recent previous financial statements, the entity:
- applies this section; or
- applies FRS 102 retrospectively as if it had never stopped applying the standard. [FRS102.35.2]

35.5 On the date of transition to FRS 102, except as noted in paragraphs 35.8 to 35.29 of this publication, an entity:
- recognises and measures assets and liabilities in line with FRS 102;
- does not recognise assets or liabilities if not permitted by FRS 102; and
- reclassifies types of assets or liabilities or equity components to those required by FRS 102. [FRS102.35.7]

35.6 An opening balance sheet at the date of transition to FRS 102 is not required to be presented. [FRS102.35.7]

35.7 Adjustments to items as a result of transition to FRS 102 are recognised in retained earnings or another more appropriate category of equity at the date of transition. [FRS102.35.8]

35.8 On transition to FRS 102 an entity does not retrospectively change its accounting for the following:
(a) derecognition of financial assets and liabilities:
   - when these were derecognised under the previous framework they are not recognised on transition to FRS 102; and
   - when these would have been derecognised under FRS 102 but were not derecognised under the previous framework, an entity can choose either to derecognise them on transition or to continue to recognise them until disposed of or settled;
(b) hedge accounting:
   - for hedging relationships that no longer exist at the transition date, an entity does not change its previous hedge accounting; and
   - for hedging relationships that exist at the transition date, an entity applies Section 12 Other financial instruments issues. If the hedge relationship does not meet the conditions for hedge accounting in Section 12, then the requirements for discontinuing hedge accounting apply;
(c) accounting estimates – when an accounting estimate was made under the previous GAAP this is not changed on transition;
(d) discontinued operations;
(e) non-controlling interest (NCI) – an entity accounts prospectively from the date of transition for the following, unless the entity restates its business combinations from an earlier date (see paragraph 35.9 of this publication):
   - the allocation of profit and total comprehensive income between the owners of the parent and the NCI;
   - changes in the parent’s ownership interest in a subsidiary that does not result in a loss of control;
   - loss of control over a subsidiary. [FRS102.35.9]
IFRS35.1 IFRS 1 requires presentation of a third statement of financial position, at the transition date, adjacent to those for the reporting date and comparative period end.

IFRS35.2 The appendices to IFRS 1 include lists of possible exemptions on transition to IFRS. There are exemptions that are additional to the list in Section 35 Transition to FRS 102, including exemptions relating to transfers of assets from customers, financial asset and liability recognition and severe hyperinflation. There are also exemptions in Section 35 that are not in the IFRS 1 appendix, including that relating to dormant companies.

IFRS35.3 The reconciliation disclosure requirements under FRS 102 are less detailed than under IFRS 1. IFRS 1.25 requires sufficient detail to be given to understand the material adjustments to the statement of financial position, statement of comprehensive income and statement of cash flows. FRS 102 requires a reconciliation of equity and of profit and is not specific about the level of detail required to be given for material adjustments.
First-time adoption exemptions

35.9 **Business combinations** – an entity may choose not to apply Section 19 *Business combinations and goodwill* to business combinations and group reconstructions before the transition date. Similarly, a public benefit entity may choose not to apply Section 34 *Specialised activities* to public benefit entity combinations before the transition date. If the entity chooses to apply Sections 19/34 to such a combination it restates all later combinations. [FRS102.35.10(a),(q)]

35.10 When an entity does not retrospectively apply Section 19, the previously acquired assets and liabilities are recognised in line with paragraphs 35.5, 35.7 and 35.11-24 of this publication except that:

- intangible assets previously included in goodwill are not recognised separately; and
- the carrying amount of goodwill is not adjusted. [FRS102.35.10(a)]

35.11 When an entity determined under a previous GAAP that goodwill had an indefinite useful life, it will need to reassess goodwill to determine its useful life under FRS 102 and amortise over that period going forward. [FRS102.ACA.161]

35.12 **Share-based payment transactions** – an entity is not required to apply Section 26 *Share-based payment to equity instruments* granted before the transition date, or to share-based payment liabilities that were settled before the transition date. Entities previously applying FRS 20/IFRS 2 continue to apply that standard at the date of transition to equity instruments granted before the transition date. Alternatively they may choose to apply Section 26. [FRS102.35.10(b)]

35.13 **Fair value or revaluation as deemed cost** – an entity may use either the fair value at the transition date or the previous revaluation (under the previous GAAP) at or before the transition date of an item of property, plant and equipment, investment property or intangible asset (where eligible for revaluation under Section 18 *Intangibles assets other than goodwill*, see paragraph 18.19 of this publication) as its deemed cost on transition. [FRS102.35.10(c),(d)]

35.14 **Individual and separate financial statements** – if an entity chooses to measure its investment in subsidiaries, associates or joint ventures at cost under Section 9, 14 or 15, respectively, then the opening cost is determined in line with that section or may be deemed to be the carrying amount at the transition date under the previous GAAP. [FRS102.35.10(f)]

35.15 **Compound financial instruments** – if the liability element of a compound instrument is not outstanding at the transition date, an entity is not required to split the instrument into its equity and liability components. [FRS102.35.10(g)]

35.16 **Designation of previously recognised financial instruments** – FRS 102 permits certain financial instruments to be designated as at fair value through profit or loss. In addition to this, FRS 102.35.10(s) permits any financial asset or financial liability that meets the criteria in FRS 102.11.14(b) at the transition date to be designated at fair value through profit or loss. [FRS102.35.10(o)]

35.17 **Service concession arrangements** – operators are not required to apply the FRS 102 models of financial asset or intangible asset to service concession arrangements entered into before the transition date. They continue to apply their previous accounting policies to these arrangements. [FRS102.35.10(i)]

35.18 **Extractive activities** – under previous UK GAAP an entity may have accounted for exploration and evaluation assets together with assets in the development and production phases. At transition date the entity may elect to measure those assets under a previous GAAP whilst accounting for them separately. The total carrying value is allocated using amounts determined under the entity’s previous GAAP between exploration and evaluation assets and then to assets in the development or production phases. The development or production assets will be allocated to underlying assets pro rata on the basis of reserve volumes or values. The entity tests these exploration and evaluation assets and assets in the development and production phases for impairment under Section 34 and Section 27 *Impairment of assets* respectively. [FRS102.35.10(j)]

35.19 **Lease arrangements** – an entity may choose to assess whether an arrangement contains a lease using the facts and circumstances at the transition date rather than the commencement date of the arrangement. [FRS102.35.10(k)]

35.20 **Lease incentives** – when a lease commenced before transition date an entity can continue to recognise lease incentives under its previous GAAP. [FRS102.35.10(l)]

35.21 **Decommissioning liabilities included in the cost of property, plant and equipment** – an entity can choose to measure the decommissioning cost that is included in the cost of the property, plant and equipment under FRS 102.17.10(c) at the transition date or at the original obligation date. [FRS102.35.10(l)]

35.22 **Dormant companies** (UK only) – a company within the Companies Act definition of dormant may retain its existing accounting policies until a change occurs in its existing account balances or it undertakes a new transaction. [FRS102.35.10(m)]

35.23 **Deferred development costs as deemed cost** – an entity may choose to take costs deferred in accordance with SSAP 13 as the deemed cost at transition date. [FRS102.35.10(n)]

35.24 **Borrowing costs** – an entity may use the transition date as the date on which capitalisation of borrowing costs on qualifying assets commences, if it chooses to adopt a policy of capitalisation under FRS 102. [FRS102.35.10(o)]
35.25 If a subsidiary, associate, or joint venture adopts FRS 102 after its investor, the assets and liabilities of the subsidiary, associate or joint venture are measured in its financial statements at:

- the carrying amounts that would be included in the investor’s consolidated financial statements if no adjustments were made for consolidation procedures and for the effects of the business combination in which the entity was acquired; or
- the carrying amounts under FRS 102, which may differ from the above if the entity had previously been acquired in a business combination; takes transition exemptions; or has different accounting policies from its investor. [FRS102.35.10(r)]

35.26 If an entity adopts FRS 102 after its subsidiary, associate or joint venture, its consolidated financial statements include the same amounts for assets and liabilities as in the financial statements of that subsidiary, associate or joint venture, adjusted for consolidation and the acquisition of the entity. [FRS102.35.10(r)]

35.27 If a parent adopts FRS 102 in its separate financial statements after or before it has done so in its consolidated financial statements, it includes the same amounts in both financial statements except for consolidation adjustments. [FRS102.35.10(r)]

35.28 If it is impracticable to restate any assets or liabilities in accordance with the requirements of Section 35, an entity applies the requirements to the earliest period practicable and discloses the data that are not adjusted to comply with FRS 102. If it is impracticable to give comparative disclosures, any omissions are disclosed. [FRS102.35.11]

35.29 The exemptions on first-time adoption continue to apply until the relevant assets or liabilities are derecognised. When there is a significant change in circumstances related to these assets and liabilities an entity assesses whether continuing to apply the exemption would maintain a fair presentation in line with Section 3 Financial statement presentation. [FRS102.35.11A,B]

Disclosures

35.30 An entity discloses the impact of transitioning to FRS 102 on its financial position and financial performance. [FRS102.35.12] This includes:

(a) explaining any changes in accounting policy;
(b) a reconciliation of the entity’s equity under its previous GAAP to its equity determined under FRS 102 at the transition date and its last period end date for which financial statements were presented under its previous GAAP. For example, if an entity’s first financial statements prepared under FRS 102 are for the year ended 31 December 2015, with comparatives shown under FRS 102 for the year ended 31 December 2014, and the latest period for which it presented previous UK GAAP accounts was the year ended 31 December 2014, then the entity presents reconciliations between its equity under previous UK GAAP and under FRS 102 at 1 January 2014 (the date of transition) and at 31 December 2014 (last period end under its previous GAAP);
(c) a reconciliation of the entity’s profit or loss in respect of the latest period in the entity’s most recent annual financial statements between that calculated under its previous GAAP and its profit or loss under FRS 102. Continuing with the example in (b), the reconciliation is between the profit or loss under previous UK GAAP and under FRS 102 for the year ended 31 December 2014. [FRS102.35.13]

35.31 If an entity identifies any errors under its previous GAAP accounting then it displays these separately in its reconciliations (paragraphs 35.30(b) and (c) of this publication) from any changes in accounting policies. [FRS102.35.14]

35.32 An opening balance sheet at the date of transition to FRS 102 is not required to be presented. [FRS102.35.7]

35.33 If an entity has not previously presented financial statements it states this in its first financial statements under FRS 102. [FRS102.35.15]
## Appendix I: List of standards and interpretations referred to in this publication

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**ASB Statement**

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1. From 1 January 2014 IAS 27 is amended and is renamed IAS 27 Separate Financial Statements.
2. From 1 January 2014 IAS 28 is amended and is renamed IAS 28 Investments in Associates and Joint Ventures.
3. Superseded on adoption of IFRS 10 suite of standards.
Interpretations

IFRIC 1  Changes in Existing Decommissioning, Restoration and Similar Liabilities
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SIC-7  Introduction of the Euro
SIC-10  Government Assistance – No Specific Relation to Operating Activities
SIC-12¹  Consolidation – Special Purpose Entities
SIC-13³  Jointly Controlled Entities – Non-Monetary Contributions by Venturers
SIC-15  Operating Leases – Incentives
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SIC-29  Service Concession Arrangements: Disclosures
SIC-31  Revenue – Barter Transactions Involving Advertising Services
SIC-32  Intangible Assets – Web Site Costs
### Appendix II: Common profit and loss account and balance sheet formats from Schedules 1 and 6 to the Regulations

#### Profit and loss account

**Format 1**

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<td>2</td>
<td>Cost of sales</td>
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<td>3</td>
<td>Gross profit or loss</td>
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<td>4</td>
<td>Distribution costs</td>
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<td>5</td>
<td>Administrative expenses</td>
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<td>6</td>
<td>Other operating income</td>
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<tr>
<td>7</td>
<td>Income from shares in group undertakings</td>
</tr>
<tr>
<td>8</td>
<td>Income from participating interests(^2)</td>
</tr>
<tr>
<td>9</td>
<td>Income from other fixed asset investments(^3)</td>
</tr>
<tr>
<td>10</td>
<td>Other interest receivable and similar income(^3)</td>
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<tr>
<td>11</td>
<td>Amounts written off investments</td>
</tr>
<tr>
<td>12</td>
<td>Interest payable and similar charges(^4)</td>
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</table>

**Profit or loss on ordinary activities before taxation**\(^5\)

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</thead>
<tbody>
<tr>
<td>14</td>
<td>Profit or loss on ordinary activities after taxation</td>
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**Non-controlling interests**\(^6\)

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<th>15</th>
<th>[Extraordinary(^1) income]</th>
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</thead>
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<td>16</td>
<td>[Extraordinary(^1) charges]</td>
</tr>
<tr>
<td>17</td>
<td>[Extraordinary(^1) profit or loss]</td>
</tr>
<tr>
<td>18</td>
<td>[Tax on extraordinary(^1) profit or loss]</td>
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[Non-controlling interests\(^6\) in respect of extraordinary\(^2\) items]

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<tbody>
<tr>
<td>20</td>
<td>Profit or loss for the financial year</td>
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---

1 The amount of any provisions for depreciation and diminution in value of tangible and intangible fixed assets is disclosed in a note to the accounts.

2 In group accounts, when the group has an investment in an associate or joint venture, replace this heading with two headings: ‘Income from interests in associated undertakings’ (being the associate and/or joint venture) and ‘Income from other participating interests’.

3 Income and interest derived from group undertakings is shown separately from income and interest derived from other sources.

4 The amount payable to group undertakings is shown separately.

5 Schedule 1 Part 1 Section A Paragraph 6.

6 Treated as an item to which an Arabic number is assigned (see notes to formats). Described as minority interests in the Regulations, although the Regulations state that an appropriate alternative description of this line item may be used, hence the FRS 102 term ‘non-controlling interests’ is used here.

7 Extraordinary items are not expected to occur in practice.
Format 2

1 Turnover
2 Change in stocks of finished goods and in work in progress
3 Own work capitalised
4 Other operating income
5 (a) Raw materials and consumables
   (b) Other external charges
6 Staff costs
   (a) wages and salaries
   (b) social security costs
   (c) other pension costs
7 (a) Depreciation and other amounts written off tangible and intangible fixed assets
   (b) Exceptional amounts written off current assets
8 Other operating charges
9 Income from shares in group undertakings
10 Income from participating interests
11 Income from other fixed asset investments
12 Other interest receivable and similar income
13 Amounts written off investments
14 Interest payable and similar charges

Profit or loss on ordinary activities before taxation

15 Tax on profit or loss on ordinary activities
16 Profit or loss on ordinary activities after taxation
   Non-controlling interests
17 [Extraordinary income]
18 [Extraordinary charges]
19 [Extraordinary profit or loss]
20 [Tax on extraordinary profit or loss]
   [Non-controlling interests in respect of extraordinary items]
21 Other taxes not shown under the above items
22 Profit or loss for the financial year
Balance sheet - Format 1

A  Called up share capital not paid

B  Fixed assets
   I  Intangible assets
      1  Development costs
      2  Concessions, patents, licences, trade marks and similar rights and assets
      3  Goodwill
      4  Payments on account
   II  Tangible assets
      1  Land and buildings
      2  Plant and machinery
      3  Fixtures, fittings, tools and equipment
      4  Payments on account and assets in course of construction
   III  Investments
      1  Shares in group undertakings
      2  Loans to group undertakings
      3  Participating interests
      4  Loans to undertakings in which the entity has a participating interest
      5  Other investments other than loans
      6  Other loans
      7  Own shares

C  Current assets
   I  Stocks
      1  Raw materials and consumables
      2  Work in progress
      3  Finished goods and goods for resale
      4  Payments on account
   II  Debtors
      1  Trade debtors
      2  Amounts owed by group undertakings
      3  Amounts owed by undertakings in which the entity has a participating interest
      4  Other debtors
      5  Called up share capital not paid
      6  Prepayments and accrued income
   III  Investments
      1  Shares in group undertakings
      2  Own shares
      3  Other investments
   IV  Cash at bank and in hand

---

8 May be presented either at position A or at position C.II.5.
9 In group accounts when the group has an investment in an associate or joint venture, replace this heading with two headings: ‘Interests in associated undertakings’ (being the associate and/or joint venture) and ‘Other participating interests’.
10 Own shares held are deducted from reserves under FRS 101 and FRS 102 rather than being shown as an investment. The nominal value of own shares held is required to be shown separately under the Act.
11 The amount falling due after more than one year is shown separately for each item included under debtors. Under FRS 102, if the aggregate balance due after more than one year is sufficiently material it is disclosed on the face of the balance sheet within current assets; otherwise it is disclosed in the notes.
12 May be presented either at position C.II.6 or at position D.
D  Prepayments and accrued income

E  Creditors: amounts falling due within one year
   1  Debenture loans
   2  Bank loans and overdrafts
   3  Payments received on account
   4  Trade creditors
   5  Bills of exchange payable
   6  Amounts owed to group undertakings
   7  Amounts owed to undertakings in which the entity has a participating interest
   8  Other creditors including taxation and social security
   9  Accruals and deferred income

F  Net current assets (liabilities)

G  Total assets less current liabilities

H  Creditors: amounts falling due after more than one year
   1  Debenture loans
   2  Bank loans and overdrafts
   3  Payments received on account
   4  Trade creditors
   5  Bills of exchange payable
   6  Amounts owed to group undertakings
   7  Amounts owed to undertakings in which the entity has a participating interest
   8  Other creditors including taxation and social security
   9  Accruals and deferred income

I  Provisions for liabilities
   1  Pensions and similar obligations
   2  Taxation, including deferred taxation
   3  Other provisions

J  Accruals and deferred income

K  Capital and reserves
   I  Called up share capital
   II  Share premium account
   III  Revaluation reserve
   IV  Other reserves
      1  Capital redemption reserve
      2  Reserve for own shares
      3  Reserves provided for by the articles of association
      4  Other reserves

V  Profit and loss account
   Non-controlling interests

---

13  The amount relating to any convertible loans is shown separately.
14  The amount for creditors in respect of taxation and social security is shown separately from the amount for other creditors.
15  May be presented either at positions E.9 and H.9 (as appropriate) or at position J.
16  The amount shown for net current assets/liabilities takes into account the amount of prepayments and accrued income wherever that amount is presented.
17  The amount of allotted share capital and the amount of called up share capital which has been paid up is shown separately.
18  Treated as an item to which a letter is assigned. Described as minority interests in the Regulations, although the Regulations state that an appropriate alternative description of this line item may be used, hence the FRS 102 term ‘non-controlling interests’ is used here.
Notes to formats

The heading or sub-heading for any item does not have to be distinguished by any letter or number assigned to that item.

The headings and sub-headings in bold text (including those in blue text) above is shown on the face of the profit and loss account or balance sheet as applicable. Items to which Arabic numbers are given (e.g. 1, 2 – in plain text above) may be presented either on the face of the profit and loss account or balance sheet, or in the notes to the accounts. Items in italics above apply only to group accounts.

All items are shown in the order, and under the headings and sub-headings, given. However:

• Headings or sub-headings are not used if there is no amount to be shown for that item for both the current and preceding financial period.

• When the special nature of the entity’s business requires it, the arrangement, headings and sub-headings otherwise required in respect of items given an Arabic number (e.g. 1, 2 – in plain text above) in the balance sheet or profit and loss account format used are adapted.

• Any item required to be shown in an entity’s balance sheet or profit and loss account may be shown in greater detail than required by the particular format used.

The format used are consistent from period to period unless in the opinion of the company’s directors¹⁹ there are special reasons for a change. Particulars of, and the reasons for, any such change are given in a note to the accounts in which the new format is first used.


¹⁹ Or equivalent for non-companies.
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