The New UK GAAP

Overview

The New UK GAAP will see all current UK accounting standards withdrawn and a new financial reporting regime introduced in their place. Transition to this new framework will be a major change for UK businesses.

The existing SSAPs and FRSs will be replaced with a single standard, called ‘FRS 102: The Financial Reporting Standard applicable in the UK and Republic of Ireland’, or FRS 102 (previously known as the FRSME). An option of IFRS with disclosure exemptions, FRS 101 Reduced Disclosure Framework, is also available for most subsidiary and parent company individual accounts.

There will be implications beyond the accounting as well as practical and resourcing issues, particularly where there are long-term arrangements such as bank loan covenants that could be affected.

These changes will be effective from 1 January 2015, which means that 31 December 2015 year end accounts will be the first prepared under the new regime. As comparatives will be restated, the first balance sheets prepared using the new requirements will be as at 1 January 2014.

Key changes

Transition from UK GAAP to the new standards is likely to alter some of the reported numbers for most businesses. This could affect the accounting profit and the assets and liabilities reported on the balance sheet. Some of the key changes are summarised below:

- **Investment property** - Current UK GAAP requires investment properties to be revalued each year to open market value. FRS 102 requires revaluation each year to fair value (equivalent to open market value) with value changes taken to profit or loss. The cost less depreciation model is used only if fair value cannot be measured reliably without undue cost or effort. There is no exemption in the individual entity accounts for properties being carried at fair value where they are used by other group companies.

- **Lease accounting** - FRS 102 classifies leases into finance leases and operating leases based on whether the lessee or the lessor holds the risks and rewards of ownership. This is the same principle as current UK GAAP; however current UK GAAP also includes a presumption that where the present value of the minimum lease payments is 90% or more of the fair value of the asset, then the lease is a finance lease. **FRS 102 does not include this ‘90% test’** but replaces it with a number of criteria designed to assess risk and reward, so the classification of some leases may change. Under current UK GAAP, the value of a lease incentive, such as a rent-free
period, is spread over the period to the first rent review, being the point at which the rent is reset to market rates. Under FRS 102, lease incentives are spread over the lease term, which may be a significantly longer time period.

- **Financial instruments** - FRS 102 classifies financial instruments into ‘basic’ and ‘other’. (Companies will also have the option of adopting the recognition and measurement criteria of full IFRS)
  - **Basic financial instruments** - These include items such as trade receivables (debtors), trade payables (creditors) and straightforward bank loans. They are measured under FRS 102 mostly at amortised cost, with certain types being measured at cost or fair value. However, most receivables and payables that are classified as current assets or current liabilities will be measured at the undiscounted amount of cash expected to be paid or received.
  - **Other financial instruments** - This category will include instruments such as foreign exchange forward contracts and loans with complex terms. Under FRS 102, these are almost all measured at fair value at each balance sheet date with movements recognised in profit or loss. Many of these instruments would not have been recognised on the balance sheet under current UK GAAP, but simply disclosed.

- **Deferred tax** - Current UK GAAP takes a timing difference approach to deferred tax, based on the mismatch between the periods in which gains and losses are recognised in the financial statements and the period in which the tax effects arise. FRS 102 is based on the same approach, but also requires **deferred tax to be recognised on items such as the revaluation of property**. Discounting of deferred tax balances is a permitted treatment in current UK GAAP but is not allowed under FRS 102.

- **Intangible assets and goodwill** - Current UK GAAP presumes a maximum useful life of 20 years, but this can be rebutted if a longer or indefinite life can be justified. Under FRS 102, intangible assets and goodwill always have a finite life. If no reliable estimate can be made, the useful life will be limited to a maximum of five years.

- **Investments in listed shares** - Under current UK GAAP, investments held in listed shares may be measured at cost or fair value. FRS 102 requires the use of fair value for investments in shares which are publicly traded or where the fair value can be measured reliably. Movements in this fair value are recognised in profit or loss.

- **Foreign exchange** - Under SSAP 20 Foreign currency translation in current UK GAAP, where matching forward contracts are in place for a transaction, the contracted rate can be used for translation of the matched transaction. This option is not permitted under FRS 102. Instead, a foreign exchange forward contract will be recognised on the balance sheet as a financial instrument at fair value and the associated debtor or creditor will be retranslated at the year-end rate.

### What should I be doing now?

These changes could have a number of important business implications. In some cases, the affected arrangements may be put in place before the transition date, so it is worthwhile thinking about the terms of these arrangements in advance.

Loan covenant tests are frequently based on profit or balance sheet measures, and transition may affect the headroom on these covenants. For example, interest rate swaps will need to be recognised on the balance sheet at fair value, which could alter balance sheet measures such as the current ratio. Also movements in the fair value of investment properties will affect measures such as profit before tax, used to calculate a bonus or determine the vesting of share options and therefore alter the effectiveness of employee incentive schemes.

As all companies within a group will need to undergo transition at the same time, this may be a good time to think about simplifying the structure and reducing the number of companies within the group.

The need to restate the comparative figures when the first accounts are prepared under the new standards will effectively mean preparing two sets of financial statements in that year. This, together with the need to assess what adjustments will be required, is likely to take up additional resource, and it will be beneficial to start planning early for the extra workload. It will also be necessary to consider who will require training in the new standards, to what level and at what time.

Our experience of assisting companies with transition to IFRS is that transition usually takes longer than anticipated, but that careful planning and control of the process can minimise the disruption.

### Who to contact

If you would like to find out more about the New UK GAAP please contact:

James Moss  
Associate Director  
T +44 (0)207 728 2967  
E james.moss@uk.gt.com