

How will moving from UK GAAP to the **FRSME** from July 2013 **impact on my company's accounts?**

The Accounting Standards Board has proposed replacing existing UK GAAP with the **Financial Reporting Standard for Medium-sized Entities (FRSME)** for UK companies that are not publicly accountable. This change is planned for July 2013. The FRSME is based on the International Financial Standard for Small and Medium-sized Entities (IFRS for SMEs), amended to be suitable for use in the UK. The introduction of the FRSME would have a major impact on the financial statements of any entity currently preparing accounts under UK GAAP. This factsheet focuses on the major changes from UK GAAP for non-small companies that would impact the financial statements of many companies when switching to the proposed FRSME.

The proposed adoption of the FRSME would lead to some changes to the format of the financial statements and the disclosures required, but most importantly for many businesses there would be changes to the numbers as well. The proposed FRSME changes the recognition criteria for various assets and liabilities, the basis on which many items are measured and the treatment of certain gains and losses compared to current UK GAAP.

The starting point for applying the FRSME would be to restate the opening balance sheet at the start of the comparative period for the first accounts prepared under the FRSME. This is known as the date of transition. If a company prepares its first accounts under the FRSME for the year ending 30 June 2014, its date of transition will be 1 July 2012. The draft FRSME includes provisions to ease the transition.

Property, plant and equipment

Property, plant and equipment is the equivalent term in the FRSME for tangible fixed assets in UK GAAP.

Measurement basis

Under the FRSME there will be no option to revalue property, plant and equipment. Instead, it would be measured at cost, less accumulated depreciation and any impairments.

Borrowing costs

Under UK GAAP, there is an accounting policy choice regarding the capitalisation of finance costs directly attributable to construction of a tangible fixed asset. Under the FRSME, there would be no such choice: all borrowing costs would be recognised as an expense as incurred.

Highlights

The proposed FRSME will change not only the format of, and disclosures in, financial statements but also:

- the criteria for recognition of some assets and liabilities
- the measurement basis of some items
- the treatment of some gains and losses.

Investments in listed shares

Under UK GAAP, investments held in listed shares may be measured at cost or fair value. The FRSME would require 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.

Investment property

UK GAAP requires investment properties to be revalued each year to open market value. The FRSME would require revaluation each year to fair value, with value changes taken to profit or loss. It would allow the cost less depreciation model to be used if fair value could not be measured reliably without undue cost or effort.

Financial instruments

The proposed FRSME classifies financial instruments into 'basic' and 'other'. (Companies also have the option of adopting the recognition and measurement criteria of IAS 39 **Financial Instruments: Recognition and Measurement**, with the disclosures as specified in the FRSME.)

Basic financial instruments

These would include items such as trade receivables (debtors), trade payables (creditors) and straightforward bank loans. They would mostly be measured 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 would be measured at the undiscounted amount of cash expected to be paid or received.

Other financial instruments

This category would include instruments such as foreign exchange forward contracts and loans with complex provisions. These would almost all be 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 UK GAAP, but simply disclosed. Hedge accounting is permitted under the proposed FRSME only for certain specified types of hedges.

Accounting for business combinations

The FRSME would not change the requirements for consolidated accounts to be prepared. The FRSME would require the use of the purchase method (acquisition accounting) for all business combinations within its scope, although the proposed standard does not address common control transactions.

Intangible assets and goodwill

Useful economic lives

For intangible assets and goodwill, 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 the proposed FRSME, all intangible assets have a finite life. If no reliable estimate can be made, the useful life is presumed to be ten years. For goodwill, the useful life is presumed to be five years or less, unless it has a longer useful economic life.

Measurement of intangible assets

The FRSME would require intangible assets to be measured at cost less accumulated amortisation and impairment losses. Unlike UK GAAP, revaluation of intangible assets would not be permitted in any circumstances.

Capitalisation of development costs

Capitalisation of development costs is permitted under UK GAAP as long as strict criteria are met. However, no capitalisation of any internal expenditure would be permitted under the FRSME, which explicitly states that development expenditure must be expensed when it is incurred.

Recognition in business combinations

The criteria for recognition of the identifiable assets and liabilities of an acquiree differ from UK GAAP, where such assets and liabilities have to be capable of being disposed of or settled separately. There is no equivalent 'separation' requirement in the proposed FRSME, meaning more intangible assets are likely to be identified separately from goodwill.

Defined benefit pension schemes

The valuation method required by the draft FRSME is the projected unit credit method, as under UK GAAP. However the FRSME would provide a number of simplifications where this basis would require undue cost or effort. The FRSME also would not require use of an independent actuary, compared to the requirement under UK GAAP to obtain a valuation by a qualified actuary at least every three years.

Deferred tax

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. The draft FRSME incorporates

the requirements of IAS 12 **Income Taxes**, taking a temporary difference approach, based on the difference between the carrying amount of an asset or liability in the financial statements, and its tax base. Although the differences appear subtle, the change is likely to make the calculation of deferred tax more complex and give rise to deferred tax in more situations.

Discounting of deferred tax balances is a permitted treatment in UK GAAP but would not be allowed under the FRSME.

Foreign exchange

Foreign exchange forward contracts

Under SSAP 20 **Foreign currency translation** in 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 the proposed FRSME (or FRS 23). Instead, a foreign exchange forward contract would be recognised on the balance sheet as a financial instrument at fair value.

Presentation currency

The FRSME would allow translation of financial statements into any currency ('presentation currency') from its 'functional currency' (broadly equivalent to local currency). Under UK GAAP, accounts are prepared in the local currency.

Government grants

Under UK GAAP the principle is that grant income is recognised in the same period as the expenses which they contribute to, although no income can be recognised until the conditions for the receipt of the grant have been complied with. For grants related to capital assets, the grant income is released in line with the depreciation of the related asset.

Under the proposed FRSME, government grants with performance conditions would be recognised only when those performance conditions are satisfied in full. There is no specific guidance in the draft FRSME for grants related to capital assets. Therefore, recognition of grant income under the FRSME is more likely to mean recognising all of the revenue in a single period when the conditions are met, rather than spread to match the related expense.

Any questions?

This factsheet can serve only to introduce the main issues raised by the ASB's proposals. If you need further details or advice on the potential impact on your company's financial statements, please contact the partner, director or manager at Grant Thornton who normally advises you on accounting matters. Alternatively, email your queries to us at FRSME@uk.gt.com with your contact details and we will put you in touch with a specialist in our office nearest to you.