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FRS 102 – what does it mean to me and my business?

New UK GAAP is here and if you haven't already started thinking about the impact of FRS102 on your business, then the time really is now.

What is FRS102?

Also referred to colloquially as new 'UK GAAP' or 'UK IFRS', FRS102 is the main new UK accounting standard which will soon replace all of the current FRSs and SSAPs.

Who does this impact?

Virtually all UK companies will be affected in some way by the changes.

Small companies i.e. companies who satisfy two of the three following criteria (turnover less than £6.5m, gross assets of less than £3.26m and employees less than 50), will continue to prepare their accounts under the Financial Reporting Standard for Smaller Entities (FRSSE). However, a new FRSSE is also on its way and the new rules for small companies will be drawn from FRS102.

Companies that are currently required by law to prepare their accounts under the International Financial Reporting Standards (IFRS) will be unaffected. Everyone else however, will be required to adopt the new standards.

When does this come into effect?

FRS102 comes into effect on a mandatory basis for accounting periods beginning on or after 1 January 2015, although earlier adoption is permitted.

This means that, in all likelihood, the first dated accounts that we will see adopting the new standard will have 31 December 2015 year ends.

However, this also means that, for a number of companies, the transition date will have already passed, since the comparative period in the first set of FRS102 compliant accounts will need to be restated to reflect the new rules. A balance sheet will therefore need to be prepared as at 1 January 2014 and 1 January 2015 for those earliest sets of accounts.

This means that company owners and directors need to be thinking right now about what these changes might mean.

What are the changes?

You may think that these do not affect you. However the changes that are coming may substantially affect your reported profits, tax charges and distributable reserves.
The language used is also different, so you will see reference to receivables and payables; not debtors and creditors. Property, plant and equipment, rather than fixed assets and a number of other terminology changes.

There are a number of ways in which the your reported profit will be subject to change and, although we can't list all 335 pages here, below are some of the key points:

Goodwill

Currently under Financial Reporting Standards (FRS's) and the Financial Reporting Standard for Smaller Entities 2008 (FRSSE 2008) there is a default maximum amortisation period where a reliable estimate of useful life cannot be made. This is 20 currently years.

Under the new standards this will likely be shortened to ten years.

Where there are no reliable estimates of useful life the effect will be higher charges against profits than currently, which will lower profits available for distribution.

Property revaluations

Presently any revaluation gains and losses go into a separate revaluation reserve on the balance sheet. Nothing is charged to the profit and loss account unless the revaluation reserve has been fully extinguished.

Under the new standard, revaluation gains and losses on investment properties will all go into the profit and loss account. This may have a dramatic effect on the accounting profit or loss for the period depending on the magnitude of the revaluation.

Deferred tax

A second change affecting revaluations is that of deferred tax, which is accounted for only as a provision and does not affect the actual tax payment. Presently deferred tax is not accounted for on revaluations.

This changes under the new standards and deferred tax is accounted for in full on all revaluations. This may have an immediate effect on distributable reserves if the revaluation reserve has been utilised to offset higher depreciation charges or used to issue further shares.

Holiday pay accruals

Under the new standard there is a requirement to accrue for employee holiday entitlement not taken. For entities that have not accrued for this in the past there may be a significant liability to account for, especially where the holiday entitlement period is not in line with the accounting period.

Intercompany loan balances

Many groups enter into intra-group loans for a variety of reasons. Problems will emerge where loans, that are not repayable on demand, are charged at zero rates of interest, or interest rates which are below market rates.

Under the new standard, such loans will need to be discounted to their present value. Not only is such a calculation potentially complex, but it will also impact upon profits and distributable reserves.

The small company regime

If that was not enough, companies at the smaller end of the scale are also set for some sweeping changes in the way that they will report financial information.

Small companies currently applying the FRSSE will be required to adopt a new FRSSE from 1 January 2015. From 1 January 2016 the new FRSSE will cease to exist and small companies will either be required to follow an abbreviated form of FRS102 or the micro-entity regime.

Micro-entities will be mandatorily required to apply the new legislation, known as FRS105, for accounting periods commencing on or after 1 January 2016.

These new standards are based on the recognition and measurement requirements of FRS 102 which will mean that UK GAAP will all be based on a consistent framework.

So, what does this mean?

There are a number of ways in which these changes could impact you and your business in a meaningful way.

- The language used in covenants for existing loan arrangements may not be consistent with FRS102. You may need to speak with your lender to establish what this means for your existing facilities
- There may be a significant impact on your company profits in the year of transition which will impact on the reserves available for distribution.
- As dividends can only be paid from distributable reserves this reduction in profit could affect your ability to pay dividends.
- The tax treatment will largely follow these new standards which could give rise to additional tax liabilities or, if timed properly, tax savings.
- Lower profits may affect banking covenants, bonus agreements and shareholder expectations. These may need advance discussions with the relevant organisations.
- Lower reserves and net current assets may affect credit ratings and relationships with suppliers and lenders.

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What can I do?

This need not all be as onerous as it sounds. With effective planning and thought, the impact of the changes can be effectively managed.

In addition, there also ways in which these changes can be used to your benefit, by reducing tax liabilities or improving the appearance of company balance sheets.

How can Armstrong Watson help?

At Armstrong Watson we have been planning for these changes for some time and can help in a number of ways:

- Assisting with conversion to FRS102 in first period of accounts
- Pre-emptive reviews in order to identify areas of potential impact / benefit
- Preparing statutory accounts under FRS102 where independence issues prevent the incumbent auditor from assisting
- Tax reviews to identify areas of potential saving

Get in touch

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