



Future of UK GAAP: Update

January 2012 saw the Accounting Standards Board (ASB) re-expose revised proposals for the future of financial reporting in the UK and Republic of Ireland. The following exposure drafts were issued:

- FRED 46 'Application of Financial Reporting Requirements'
- FRED 47 'Reduced Disclosure Framework'
- FRED 48 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'

The re-exposed future of UK GAAP has come about as a result of feedback to previously issued FREDs 43 to 45 and this feedback resulted in significant changes to previous proposals.

The comment period is open until 30 April 2012 and you are well-advised to submit your feedback so that the ASB can act accordingly. The proposals are expected to come into effect for accounting periods beginning on or after 1 January 2015.

The changes

As with the previous exposure drafts, FREDs 46 to 48 recommend a full replacement of all current FRSs/SSAPs and Task Force Abstracts as well as introduce a reduced disclosure framework for qualifying entities. The FREDs also propose to retain the FRSSE but recommend a further consultation on how to update the FRSSE following the European Commission proposals for the future of financial reporting for small and micro companies.

The proposals will affect all companies that are required to prepare financial statements that give a true and fair view, including those which are not corporate entities.

Publicly accountable

The proposals no longer refer to the concept of 'public accountability' because the ASB (quite rightly) acknowledged that such a concept would mean that certain unquoted entities in the financial services sector would be construed as being publicly accountable and therefore would need to produce financial statements under full EU-adopted IFRS which would be inappropriate to such entities. Instead, the ASB have included proposed changes in FRS 102 (FRED 48) which reflect the needs of preparers and users concerned with entities which would have otherwise been classed as 'publicly accountable' under the previous proposals.

Name change

The previously issued 'Financial Reporting Standard for Medium-Sized Entities' was deemed to be inappropriate in light of the broader scope of entities which would be eligible to apply proposed FRS. As a result, the name of the proposed standard has been changed to 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'.

Reduced disclosure framework

The previous FRED 43 proposed to offer all subsidiary entities a reduced disclosure framework (RDF), with the exception to those with public accountability. The removal of the



concept of public accountability meant that the ASB had to revise their proposals in this area. As a result, FRED 47 proposes that:

- (a) a qualifying entity that is not a financial institution may take advantage of the disclosure exemptions set out in FRED 47 (but to comply with company law, an entity which has financial liabilities carried at fair value that are neither held in a trading portfolio nor are derivatives must apply certain disclosure requirements which are required under IFRS 7, *Financial Instruments: Disclosures*.)
- (b) a qualifying entity that is a financial institution may take advantage in its individual accounts of the disclosure exemptions set out in FRED 47, other than those for IFRS 7 and IFRS 13, *Fair Value Measurement*.

The RDF will also be applicable to both ultimate parents and qualifying subsidiaries, hence the term 'qualifying entity'. The proposals state that a qualifying entity is a member of a group which prepares publicly available financial statements in which that member is consolidated and that the RDF cannot be applied in the consolidated financial statements of entities that are required, or voluntarily choose, to prepare consolidated financial statements.

The proposals set out those principles which are to be applied in the future development of a RDF, such as:

- Relevance
- Cost constraint on useful financial reporting
- Avoid gold plating

Other specific changes in FRED 48

Other changes include:

- The capitalisation of development costs is now permissible in certain circumstances
- The revaluation model for property, plant and equipment and intangible assets can be used
- Merger accounting is permissible for group reconstructions
- Hedge accounting is permissible for net investments in a foreign operation
- Investment entities are permitted to account for associates and joint ventures at fair value

The ASB have also clarified the following:

- Disclosure requirements in respect of discontinued operations
- The treatment of loan covenants so that these are now consistent with IFRS 9, *Financial Instruments*
- Financial instruments treated as equity under IAS 32, *Financial Instruments: Presentation* are not liabilities when an entity is required to prepare consolidated financial statements
- An employee benefit trust, ESOP or similar arrangement is a special purpose entity which has to be consolidated when the entity is a parent company and prepares consolidated financial statements
- An investor which is not a parent, but has an investment in one or more associates and/or jointly controlled entities will account for those investments/jointly controlled entities using either cost or fair value



- The presumed life of goodwill is five years – in particular when the entity cannot come up with a reliable estimate. The same presumed lifespan is also the same for intangible assets
- The accounting treatment for group share-based payments where the award is granted by the parent or another group entity
- Option pricing models do not have to be used for the valuation of share-based payments, particularly those for unquoted shares

In addition, the ASB is also proposing to change the requirements in respect of group pension plans to be consistent with the revised IAS 19, *Employee Benefits*.

Financial Instruments

Derivative financial instruments will have to be recognised on the balance sheet using fair value accounting rules.

As the International Accounting Standards Board (IASB) is in the process of replacing IAS 39, *Financial Instruments: Recognition and Measurement* with IFRS 9, *Financial Instruments* in phases, section 11 and 12 of FRED 48 broadly apply the classification and measurement requirements in IFRS 9, but as the impairment and hedge requirements in IFRS 9 are still under development by the IASB, the impairment and hedge requirements in the proposals are based on IAS 39 requirements.

Income Tax

Deferred tax will be calculated on a timing difference approach but with additional recognition requirements for certain other differences, which the ASB refer to as a 'timing difference plus' approach to provide useful information to the users as well as to allow consistency with the convergence to an IFRS-based framework and also allowing a simple solution which allows consistent treatment with current FRS 19, *Deferred Tax* requirements but would give the same answers as IFRS in most cases.

The ASB have acknowledged that the timing difference plus approach does not achieve complete consistency with IAS 12, *Income Taxes* but they considered such differences between the proposals and IAS 12 were likely to be relatively rare.

Grants

There were a number of objections to the previous proposals by those in the public-benefit sector in relation to what would have been a 'performance condition' where grants were concerned. As a result, the ASB have decided to retain the accounting for government grants which are currently permitted in EU-adopted IFRS. FRED 48 therefore includes the option to recognise grants in profit or loss on a systematic basis over the periods in which the entity recognises expenses for which grants compensate. The proposals also cover all grants, not just those from government hence the ASB have changed the title of this section in the proposals.

However, the ASB have stated that they intend to undertake a research project on the accounting for grants in the near future.



Consolidation of subsidiaries

The Companies Act 2006 outlines the circumstances when a subsidiary can be excluded from consolidation and as such the ASB can only work within the boundaries of the Companies Act. Consequently, FRED 48 proposes that a subsidiary should be excluded from consolidation when the interest in that subsidiary is held exclusively for resale and it is part of an investment portfolio.

Agricultural and Biological assets

A number of respondents complained that the proposals in this area (section 34, which are based on IAS 41, *Agriculture* would be 'unduly arduous and would not benefit the users of the financial statements'. It seems that these objections were not backed by any sort of evidence as to why this would be the case, and as such the ASB is seeking further views on this.

Retirement benefit plans

FRED 43 suggested that retirement benefit plans were publicly accountable, hence being required to apply full EU-adopted IFRS. The ASB got feedback on its proposals following the withdrawal of the publicly accountable concept and has decided to incorporate such plans within the specialised activities section, accounting requirements for retirement benefit plans which could be supplemented by the Statement of Recommended Practice (SoRP) '*Financial Reports of Pension Schemes*'. FRED 48 requires a statement of financial position (balance sheet) which excludes the liability to pay pension benefits, but this liability to pay pension benefits is required to be disclosed.

Non-cash assets

Entities are required to only disclose the fair value of any non-cash assets which have been distributed to their owners. As a result, paragraph 22.18 in FRED 44 has been amended.

Inclusion of UITF Abstracts

The following UITF Abstracts will be included:

- Abstract 4, *Presentation of long-term debtors in current assets* will be included in the legal appendix to FRED 48
- Abstract 31, *Exchange of businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associate* is withdrawn, and the accounting requirements are now incorporated in section 9 to FRED 48
- Abstract 32, *Employee benefit trusts and other intermediate payment arrangements* is withdrawn and the accounting requirements has been incorporated into section 2 of FRED 48

Related parties

Transactions between wholly-owned subsidiaries are exempt from disclosure but the ASB are going to consult on whether the disclosures proposed in FRED 48 are sufficient to meet users' needs. This is because the EC current proposals do not contain an exemption from disclosure for transactions between wholly-owned subsidiaries, and therefore if the EC's proposals go ahead the ASB would need to amend the proposals accordingly in FRED 47 and 48 to be consistent with companies legislation.



EC accounting directives

The EC issued proposals in October 2011 to amend the Accounting Directives which are subject to negotiation and agreement between EU member states and European Parliament. If these proposals proceed, the ASB would need to amend the proposals in FREDs 46 to 48 to comply with companies legislation.



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