

# The ASB plans to replace **UK GAAP** with a new financial reporting regime based on the **IFRS for SMEs** from 2013. How will this affect your business?

## What are the proposals for UK GAAP?

The ASB proposes the following approach:

Tier 1	Publicly accountable entities	full IFRS	Reduced disclosures for subsidiaries
Tier 2	Non-publicly accountable entities	FRSME	Reduced disclosures for subsidiaries
Tier 3	Small entities	FRSSE	

Any entity can elect to use the GAAP of a higher tier, for example under the proposals a Tier 3 entity could choose the **FRSME (Financial Reporting Standard for Medium-sized Entities)** or full IFRS.

## When will the changes come into effect?

The ASB proposes to adopt the new regime for financial years beginning on or after 1 July 2013 at the earliest (which would require 2012 comparatives to be restated).

## What is the FRSME?

The FRSME is based on the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). However, some amendments have been made to the IFRS for SMEs, including ensuring that it complies with UK company law.

The IFRS for SMEs is essentially a simplified version of 'full IFRS' (International Financial Reporting Standards other than IFRS for SMEs).

It was designed by the IASB (International Accounting Standards Board) as a stand-alone standard, for application by non-publicly accountable entities. It is much smaller than full IFRS, the main text of the Standard being 230 pages long. There are also far fewer disclosure requirements than full IFRS (about 300 compared to 3,000 in full IFRS).

The simplification has been achieved partly by allowing only the simple accounting policy option where full IFRS allows a choice of options.

## What will happen to the FRSSE?

It is proposed to retain the FRSSE for the next few years for small companies as defined by the Companies Act 2006.

## Highlights

- The ASB proposes to replace UK GAAP from July 2013
- Under the proposals, publicly accountable entities adopt full IFRS, small entities retain the FRSSE and non-publicly accountable, non-small entities adopt the FRSME
- There are a number of issues to be considered now

## What are the reduced disclosures for subsidiaries?

The proposals include exemptions from a number of disclosure requirements for qualifying subsidiaries. This will be most beneficial for subsidiaries of groups applying full IFRS, as relief has been given from some of the most onerous IFRS disclosures, for example financial instruments.

To qualify, a subsidiary must not be publicly accountable, must be included in consolidated financial statements which are publicly available and there must be no objection from any shareholder. However, there is no percentage ownership requirement, and subsidiaries of overseas parents would be eligible if they meet the criteria.

## What is a 'publicly accountable entity'?

The proposed definition of publicly accountable includes companies with debt or equity instruments traded in a public market (including non-regulated markets) or companies in the process of issuing such instruments. It also includes companies which take deposits and/or hold assets in a fiduciary capacity as one of their primary businesses for a broad group of outsiders.

It does not include entities which take deposits for reasons incidental to their primary business, for example estate agents and solicitors.

If an entity is publicly accountable it will need to adopt full IFRS for its parent company financial statements, as well as for the consolidated financial statements of the group.

## What about not-for-profit entities?

The proposal for not-for-profit (public benefit) entities is for a public benefit entity standard, which would supplement the FRSME where there are omissions in the standard or where different accounting is required for public benefit entities. The three not-for-profit SORPs will be retained and updated.

## **What will be the effect of using the FRSME?**

It will be simpler to apply and understand the FRSME than current UK GAAP, especially as UK GAAP has become ever more complex with different standards applying to different types of entity.

A key benefit of adopting the FRSME will be increased comparability between financial statements on an international basis, and an associated increase in access to funding. However, there will inevitably be disruption caused by the changeover.

## **What are the costs to my business?**

There will be extra work involved during the transition, particularly in terms of setting up a new format for the financial statements and making the required fair value assessments. In addition, transition will require restating the 2012/13 UK GAAP numbers for the FRSME, essentially requiring the production of two sets of financial statements for that year. Changes to the accounting systems may be needed in order to provide the required information.

External assistance may be needed on an ongoing basis, particularly with any fair value measurements required under the FRSME.

The finance department is likely to require additional resources, mainly during the transition period. Some formal training on the FRSME and how to apply it may also be beneficial.

## **Is there anything I need to think about now?**

There are definitely some issues that can be addressed now, to avoid causing unnecessary problems on transition.

## **Loan covenants**

When bank loans and associated covenants are being negotiated, it will be important to consider the impact that adoption of the FRSME is likely to have on a number of financial measures. For example, interest rate swaps will need to be recognised at fair value, which could alter balance sheet measures such as the current ratio.

## **Bonus agreements**

Alterations in accounting policies may affect the measures used to calculate a bonus, for example foreign exchange contracts will be recognised at fair value with movements recognised in the income statement, which could have a significant effect on profit before tax.

## **Corporation tax**

The effect of the FRSME on corporation tax in the UK is not yet clear, but it is likely that there will be some issues and potentially some beneficial elections available. More information will become available over the coming months.

## **Loan terms**

The terms of any loan will determine whether the loan is a 'basic' or an 'other' financial instrument under the FRSME. Basic loans will be measured at amortised cost, but 'other' loans will need to be measured at fair value at each reporting date which will require additional work.

## **Terms and conditions of shares**

The exact terms and conditions of shares that have liability features will determine whether they will be classified as 'basic' or 'other' financial instruments. As for loans, 'other' financial instruments will need to be measured at fair value at each reporting date. It may be worthwhile to revisit the terms of such shares and modify them where feasible.

## **Resource planning**

It will be beneficial to start planning early for the extra workload involved over the transition period, so that resources can be managed appropriately. As the experience of transition to full IFRS has shown, the additional time and work required should not be underestimated.

## **Group structure**

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.

## **What will be the impact on distributable profit?**

Individual company accounts prepared under the FRSME will form the basis for determining the distributable profits, in the same way as under the current requirements. The principles set out in ICAEW/ICAS Tech 01/09 will apply, but further guidance may be issued.

## **Can I have my say on the ASB's proposals?**

Grant Thornton will be responding formally to the ASB's Financial Reporting Exposure Draft. We welcome your input and suggestions which we can take into account for our response. Alternatively, you can contact the ASB directly at [asbcommentletters@frc-asb.org.uk](mailto:asbcommentletters@frc-asb.org.uk).

## **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](mailto:FRSME@uk.gt.com) with your contact details and we will put you in touch with a specialist in our office nearest to you.