FINANCIAL REPORTING FACULTY

PREPARING TO TRANSITION TO FRS 102

New UK GAAP Factsheet

Published 12 November 2013
Last updated 6 February 2015

PRACTICAL HELP IN A COMPLEX WORLD

Preparing to transition to FRS 102
This factsheet is designed to assist those adopting FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. It considers the steps you might take ahead of the preparation of the transition date balance sheet and the adjustments required when moving to FRS 102.

Key regulations for this factsheet
This factsheet includes links and references to key regulations. There's a summary of the links, and guidance on how to use them, on page 2.

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Section 1
Introduction

Preparing for transition
FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* is the cornerstone of a new financial reporting regime that represents the most significant change to UK GAAP in a generation. All extant FRSs, SSAPs and UITF Abstracts will be withdrawn when the new regime becomes effective. While still preparing financial statements under the previous GAAP, entities will need to gather information and take appropriate action so that they are able to meet the requirements of FRS 102 on first-time adoption.

Purpose of this factsheet
The purpose of this factsheet is to help those adopting FRS 102 to prioritise what needs to be done in the time leading up to the preparation of the first set of FRS 102 financial statements. Familiarity with the issues addressed in the faculty's factsheets on the new UK reporting regime has been assumed.

The factsheet addresses the transitional considerations for entities currently adopting UK GAAP (excluding those currently applying the Financial Reporting Standard for Smaller Entities). It does not address the specific needs of those engaged in specialised activities, for example financial institutions or public benefit entities. It has been updated to reflect changes made to the standard in July 2014.

The new UK financial reporting regime
FRS 102 is part of the new financial reporting regime applicable from 1 January 2015 with early adoption generally permitted. You can find out more at icaew.com/newukgaap.

Section 2

Links to regulations

Using the links and margin notes in this document

The margin notes in this factsheet identify relevant sections of standards and other regulations – these sections cannot be considered in isolation when applying them in practice.

You might find it useful to download, or print out, relevant section(s) of the standard(s) so that you can refer to them when using this document.

Standards
Key standards and regulations for this factsheet
FRS 100 *Application of Financial Reporting Requirements*
FRS 101 *Reduced Disclosure Framework*
FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*
FRS 102 – Editorial Amendments and Clarification Statements
FRS 103 *Insurance Contracts*
Other relevant regulations
The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)
FRC Staff Education Notes

Section 3

Putting transition into context

The new UK regime

The new regime currently consists of four standards:

- FRS 100 *Application of Financial Reporting Requirements*;
- FRS 101 *Reduced Disclosure Framework*;
- FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and
- FRS 103 *Insurance Contracts*.

The FRSSE[1] continues to be available to those entities that are eligible to use it for the time being.

Further faculty factsheets
Answers to frequently asked questions about the new standards and the new regime can be found in the factsheet *The New UK Regime.* This factsheet also considers practical implications arising from the move to the new regime

Adopting FRS 102

Prior to adopting FRS 102, entities will first need to consider where they fit into the new UK regime and the options available to them. FRS 100 sets out the overall framework for financial reporting and which standards apply to which type of entity.

FRS 102 is expected to be adopted by the majority of large and medium-sized private entities and many other entities currently adopting UK GAAP. However, other options may be more attractive to some, for example entities that currently use the FRSSE may wish to continue to do so for the time being and entities in a group that applies IFRSs when preparing its consolidated financial statements may wish to adopt FRS 101.

Further faculty factsheets
The factsheet *Reduced Disclosure Regime* provides more details on applying FRS 101.

FRS 102 requirements

FRS 102 sets out the recognition, measurement and disclosure requirements for the financial statements within its scope. An overview of the requirements of FRS 102, the accounting choices available and key differences between FRS 102 and current UK GAAP are considered in the faculty's factsheet *The New Financial Reporting Standard*.

Practical tip: review of existing accounting policies

At an early stage entities will need to perform a detailed review of whether their current accounting policies meet the requirements of FRS 102 and whether change is necessary or desirable. In some cases the requirements under FRS 102 will be different from current GAAP and changes in accounting policy will be inevitable. However, transition to FRS 102 can also provide an opportunity to look again at current accounting policies and reconsider their appropriateness to the business. In some cases there will also be accounting options that were not previously available.

Complex areas of accounting

Some topics are likely to present much more of an accounting challenge under FRS 102 than under existing requirements, for example financial instruments and business combinations. The faculty is planning to publish further factsheets exploring common problem areas in greater depth in due course. Such areas are explored in this factsheet only to the extent that they have implications for the transition process.

Further faculty factsheets
The factsheet *FRS 102: Financial Instruments* provides further guidance.

[1] The new EU Accounting Directive will, when implemented into UK company law, make significant changes to small company reporting. The FRC is currently consulting on withdrawing the FRSSE and bringing small entities within the scope of an updated version of FRS 102, albeit with certain disclosure exemptions.

Form and content of the first FRS 102 financial statements

There will be much to think about when preparing your first set of FRS 102 financial statements, including the form and content of those financial statements and the various disclosures required. This factsheet considers the disclosure requirements that have implications for the transition stage ie, the information to be gathered or requested at the point a specific transaction occurs or at transition.

The steps to a successful transition

The purpose of this factsheet is to guide you through the adjustments that may be required to your balance sheet at the transition date and the comparative information to be prepared under the new UK GAAP. Approaching this process in an orderly manner will make the preparation of the first set of FRS 102 financial statements easier in due course. However, the steps necessary will vary from entity to entity, and this factsheet is not a substitute for careful reading of the standard.

Practical tip: time is of the essence

FRS 102 generally requires retrospective application so it is important to identify those areas most likely to have a significant impact on your financial statements and actions which might be taken to ease the burden, for example deciding which exemptions to take. In particular, you need to identify those actions which are time-critical ie, areas where action (or inaction) at transition will have a direct impact on the accounting treatment and the options available. Particular care will need to be taken by entities that engage in hedging activities or that have defined benefit pension schemes. These – and other time critical issues – are discussed further in sections 7 and 8 below. Having identified your priorities and any urgent actions required, other aspects of transition may be considered at a later stage.

Look for the alarm clock icon in the right-hand margin of this factsheet to help you identify those actions that are time-critical.

Amendments to FRS 102 made in July 2014

In July 2014, the FRC issued amendments to FRS 102 to improve the accounting for financial instruments. These amendments:

- Relaxed the conditions for financial instruments to qualify as 'basic' meaning that more debt instruments – such as bank loans – will be measured at amortised cost rather than at fair value; and
- Updated the requirements on hedge accounting, making hedge accounting more readily available to entities where it is consistent with their risk management processes.

Sections 6 and 7 of this factsheet include more details of these changes, which are effective for accounting periods beginning on or after 1 January 2015 ie, the same date as FRS 102.

Practical tip: make sure you have the right version of the standard

A revised version of FRS 102 was published in August 2014 incorporating not only the updated financial instruments requirements issued in July 2014 but also assorted editorial amendments and corrections to minor typographical errors. First time adopters should only refer to this latest version of FRS 102.

Future development of FRS 102

The FRC plans to carry out a review of FRS 102 every three years which is in line with the IASB's policy for the IFRS for SMEs. The first three year review will take place in 2016/17 with a view to the revised FRS 102 being effective in 2018.

The FRC previously indicated that it would revisit the requirements of FRS 102 on impairment of financial assets when the IASB finalised IFRS 9 *Financial Instruments*. Although the IASB has now issued IFRS 9, the FRC does not intend to make any changes in relation to impairment in FRS 102 before its first triennial review of the standard.

The FRC has issued a number of editorial amendments and clarification statements which have arisen from queries arising on the implementation of the standard for the first time.

FRC staff have also published fifteen Staff Education Notes which aim to illustrate certain requirements of FRS 102 to aid entities with the transition to new UK GAAP.

As noted above, the FRC is currently consulting on withdrawing the FRSSE and bringing small entities within the scope of an updated version of FRS 102, albeit with certain disclosure exemptions.

A summary of the developments in FRS 102 can be found by visiting the New UK GAAP page on the FRC's website.

Section 4

First-time adoption of FRS 102 – general

Timing

FRS 102.1.14

FRS 102 is effective for accounting periods beginning on or after 1 January 2015. Early application is generally permitted for accounting periods ending on or after 31 December 2012.

However, for entities that are within the scope of a Statement of Recommended Practice (SORP), early application is allowed only if the requirements of FRS 102 do not conflict with the requirements of the current SORP or legal requirements for the preparation of financial statements. A summary of the current status of SORPs can be found on the FRC website. If an entity applies FRS 102 for a period beginning before 1 January 2015 it must disclose that fact.

Transition requirements

Section 35 of FRS 102, *Transition to this FRS*, sets out the requirements that an entity must follow when adopting FRS 102 for the first time, irrespective of the standards or reporting framework previously applied.

Establishing the date of transition

FRS 102.35.6

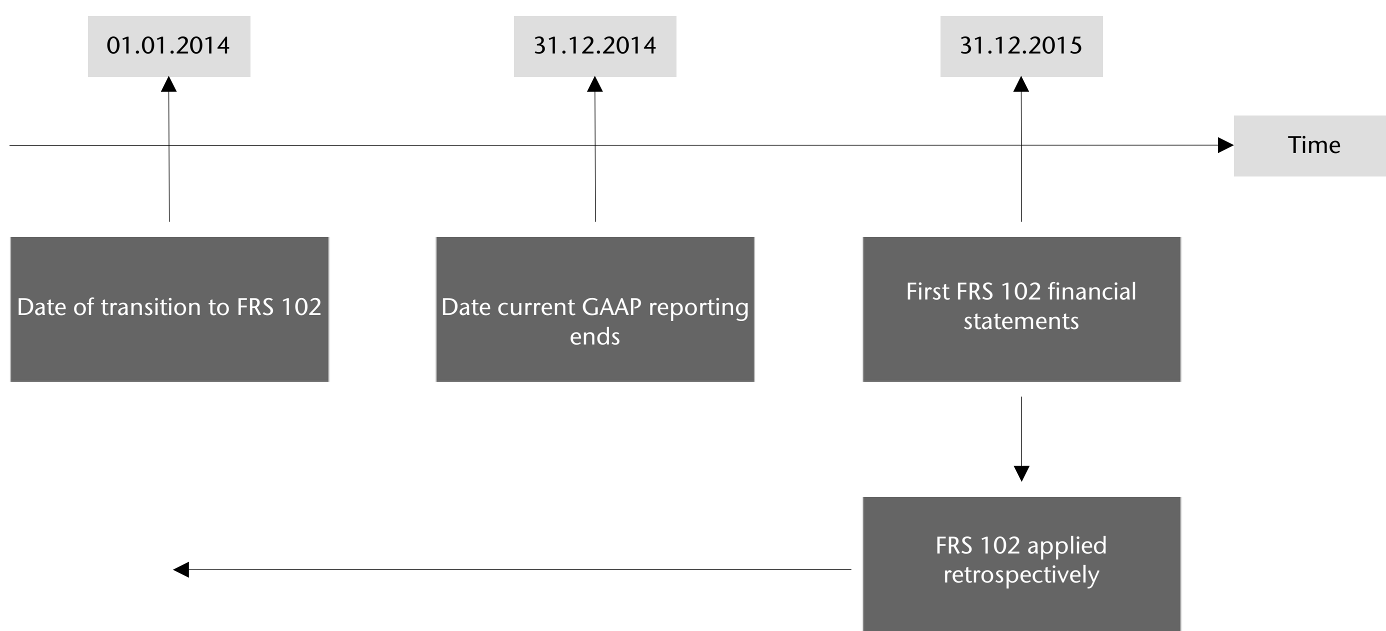
The date of transition is the beginning of the earliest period for which an entity presents full comparative information under FRS 102 in its first financial statements that comply with that standard.

For example, if a company's first FRS 102 financial statements are to be prepared as at 31 December 2015, given the requirement to present at least one year's comparatives, the date of transition would typically be 1 January 2014.

Practical tip: information required for the restatement of comparatives

Do not underestimate the challenge of restating comparative information, including numerical and narrative disclosures, on first-time adoption of FRS 102. There may be disclosures not required previously or which are required in greater depth. This information will generally be easier to gather at the time a transaction takes place or on or near the date a particular balance arises, than when the first FRS 102 financial statements are being prepared.

FRS 102 adoption timeline



Practical tip: planning for transition

For an entity adopting FRS 102 for the first time in 2015, as we can see from the timeline above, it is the balance sheet as at 31 December 2013 that will form the basis for the opening figures in the FRS 102 financial statements as at 1 January 2014. The FRS 102 balance sheet may include assets and liabilities not previously recognised, and previously recognised balances may be measured according to different requirements. If you have not done so already you should begin work on your transition date balance sheet as soon as possible as the longer you leave it the more difficult it may be to track down the information required. Furthermore, transactions and contracts entered into in 2014 although initially accounted for under current GAAP will need to be restated for the comparative information to be presented under FRS 102. This is particularly important as the exemptions available on transition are generally not available for transactions entered into **after** the transition date.

Preparing the transition balance sheet

FRS 102.35.7

The general requirement is that FRS 102 be applied retrospectively and therefore the transition balance sheet must be prepared in accordance with the requirements of FRS 102, with some limited exceptions. Therefore the transition balance sheet must:

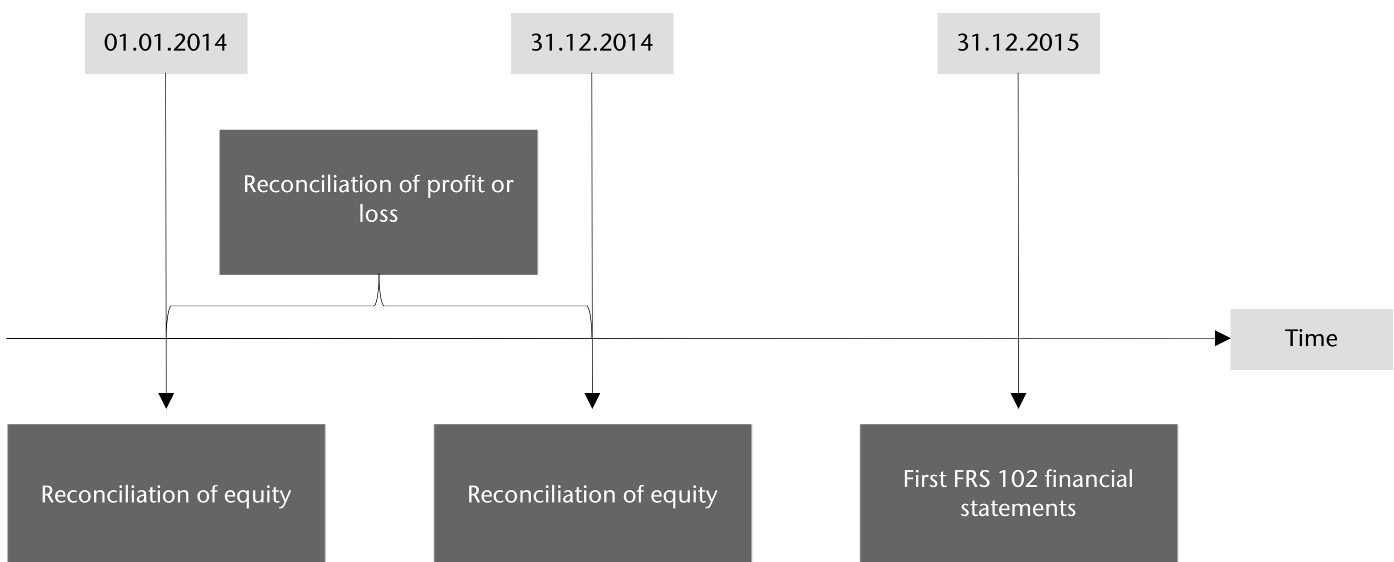
- recognise all assets and liabilities whose recognition is required by FRS 102;
- not recognise items as assets or liabilities if FRS 102 does not permit such recognition;
- reclassify items that are recognised in accordance with previous GAAP as one type of asset, liability, or component of equity, but are a different type of asset, liability or component of equity under FRS 102; and
- apply FRS 102 in measuring all recognised assets and liabilities.

FRS 102. 35.8

Adjustments to the transition balance sheet as a result of changes in accounting policy will be recognised directly in retained earnings or, if appropriate, another category of equity, at the date of transition.

The transition balance sheet does not need to be presented in the first set of FRS 102 financial statements but a reconciliation of equity is required (see below).

Reconciliations[2] to be presented in first FRS 102 financial statements



[2] Illustrative examples of these reconciliations are included in Appendix 1.

FRS 102 requires a reconciliation of an entity's equity determined in accordance with the previous GAAP to its equity determined in accordance with FRS 102 for both the following dates:

FRS 102.35.13

- the date of transition to FRS 102; and
- the end of its latest period presented in the entity's most recent annual financial statements prepared in accordance with the previous GAAP.

Also required is a reconciliation of the profit or loss determined in accordance with previous GAAP for the latest period in the entity's most recent annual financial statements to the profit or loss determined under FRS 102 for the same period.

Exceptions and exemptions to retrospective application

FRS 102.35.9 and 102.35.10

There are four instances when FRS 102 **prohibits** full retrospective application of the requirements of the standard. In addition there are 18 optional exemptions that can be **selected** on an individual basis. These exceptions and exemptions are discussed further below and in later sections in this factsheet.

Exceptions – mandatory	Exemptions – optional
• Accounting estimates (see below)	• Dormant companies (see below)
• Derecognition of financial assets and financial liabilities (section 6)	• Fair value as deemed cost (see below)
• Measuring non-controlling interests (section 9)	• Revaluation as deemed cost (see below)
• Discontinued operations*	• Designation of previously recognised financial instruments (section 6)
	• Hedge accounting (section 7)
	• Decommissioning liabilities included in the cost of property, plant and equipment (section 8)
	• Lease incentives (section 8)
	• Business combinations, including group reconstructions (section 9)
	• Individual and separate financial statements (section 9)
	• Deferred development costs as a deemed cost (section 9)
	• Borrowing costs (section 9)
	• Assets and liabilities of subsidiaries, associates and joint ventures (section 9)
	• Share-based payment transactions (section 10)
	• Compound financial instruments (section 10)
	• Arrangements containing a lease (section 10)
	• Service concession arrangements – Accounting by operators*
	• Extractive industries*
	• Public benefit entity combinations*

*Exemptions relating to specialised activities and presentation issues are not covered in this factsheet.

Dormant companies

FRS 102.35.10 (m)

A dormant company may elect to retain its accounting policies for reported assets, liabilities and equity at the date of transition to FRS 102 until there is any change to those balances or the company undertakes any new transactions.

Practical tip: don't delay if planning any changes

If any changes are planned that will affect the balances in the dormant company financial statements, it may be beneficial to make the changes before the date of transition. This should ensure that the company can take advantage of the exemption not to restate its accounting policies.

Accounting estimates

FRS 102.35.9

The estimates used in preparing the balance sheet at the date of transition to FRS 102 (and in preparing the comparative amounts to be included in the first FRS 102 financial statements) must be consistent with those used under previous GAAP, unless there is objective evidence that those estimates were in error. This requirement is consistent with the principles in Section 32 *Events after the Reporting Period* for determining whether events arising after the balance sheet date are adjusting or non-adjusting.

Illustrative example: estimate of recoverability of a debtor

A company has a 31 December year end. Included in its financial statements for the year ended 31 December 2013, prepared under the previous GAAP, was an amount owing from X which, given the information available at the balance sheet date, was considered to be recoverable. Late in 2014 X was declared insolvent and the amount was written off in the financial statements for the year ended 31 December 2014.

The company is preparing its first FRS 102 financial statements for the year ended 31 December 2015. Although it is now known that the amount owing from X was not recoverable it will still need to be included in the company's opening FRS 102 balance sheet and the write off reported as a loss in the comparative profit and loss account as restated in the 2015 financial statements.

Illustrative example: estimate of useful life of an asset

A company has a 31 December year end. Included in its financial statements for the year ended 31 December 2014, prepared under the previous GAAP, was an item of plant and machinery acquired five years previously with an estimated useful life of 20 years. The asset had been depreciated over the 20 year useful life on a straight line basis.

The company is preparing its first FRS 102 financial statements for the year ended 31 December 2015. When preparing its financial statements, the company considers that the item of plant and machinery is wearing out more quickly than previously envisaged and revises its estimated remaining useful life to 12 years from 1 January 2015 (as compared to 15 based on original estimates).

Although it is now known that the estimated remaining useful life of the asset at the comparative balance sheet date is 12 years as opposed to 15, there is no retrospective adjustment to the carrying value of the asset or reserves to reflect an additional depreciation charge.

However, new estimates may be necessary due to changes in accounting policies as a result of moving to FRS 102. A company may also need to prepare estimates that were not required under the previous GAAP, for example for any intangibles not previously amortised for which the entity will need to estimate the remaining useful life. These estimates will need to reflect the conditions that existed at the date of transition to FRS 102, or at acquisition if an intangible is acquired during the comparative period.

Deemed cost

FRS 102.35.10 (a), (f), (n)

There are three instances when the carrying amount under the previous GAAP may be used, or in the case of goodwill (if the exemption not to restate the business combination has been selected) must be used, as a surrogate amount for cost or depreciated cost at the transition date:

- deferred development costs;
- investments in subsidiaries, jointly controlled entities and associates; and
- goodwill.

FRS 102.35.10 (c), (d)

There are also cases when a fair value or revalued amount can be used as deemed cost:

- property, plant and equipment;
- investment property; and
- intangible assets that meet the recognition criteria and the criteria for revaluation in Section 18 *Intangible Assets other than Goodwill* (this is expected to be rare).

Additional provisions for deferred tax may be necessary for assets when the deemed cost is based on the fair value or revalued amount.

Practical tip: establish fair values at the appropriate time

Although usually it will be possible to obtain fair values at a later date, it will involve more effort and research than if the valuations are done as close as possible to the date to be reflected in the valuation.

FRS 102 Appendix 1

Subsequent depreciation or amortisation will assume that the entity initially recognised the asset or liability at the transition date and that its cost was equal to the deemed cost.

Practical tip: using deemed cost

The use of fair values as deemed cost means that, in effect, the entity will be taking advantage of the Alternative Accounting Rules in The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410). As a result, additional disclosures will be required in the financial statements going forward, and a revaluation reserve will be recognised for any gain or loss arising on the revaluation.

These options are considered further in sections 9 and 10 of this factsheet.

Procedures before transition

Prior to transition, each entity will need to consider the following in respect of its assets and liabilities, including those not previously recognised:

- Do the assets and liabilities meet the recognition requirements of FRS 102?
- Are the assets and liabilities classified in accordance with FRS 102?
- Are the assets and liabilities measured in accordance with FRS 102?
- Are there choices in accounting treatment? If so, are there any additional steps that need to be fulfilled to take advantage of the choices available?
- Are there any exceptions or exemptions to retrospective application available on transition?
- When fair values are required for measurement or disclosure purposes, are the fair values readily available or do additional requests or calculations need to be made?
- What is the impact of the changes on other aspects of the business eg, distributable profits, tax, bank covenants and compensation arrangements?
- What actions could be taken to avoid any unintended consequences arising from the adjustments required?

Practical tip: determining priorities

Some areas of the financial statements will be more specifically affected than others by the changes in accounting policies. As part of the planning process it may be useful to produce a table of the items in the financial statements and identify the extent to which these will be affected by moving to FRS 102 using an 'ABC' (or similar) grading, where:

- 'A' represents items likely to have major issues or impact on conversion to FRS 102;
- 'B' represents modest impact or issues;
- 'C' represents items that are unlikely to be significantly affected.

Such an approach is designed to focus attention at an early stage on the key areas in which additional resource or expertise may be required.

Materiality

FRS 102.2.6

Materiality is one of the qualitative characteristics of information in financial statements. Materiality will, therefore, be a consideration when applying the requirements of FRS 102 on transition as well as in future accounting periods.

Section 5

Group structures, interests in other entities and the implications for the financial statements

Overview

Accounting policy choices and exemptions available on transition may, in part, be dictated by whether an entity is a parent and/or is itself part of a larger group.

Consolidated financial statements

If an entity is a parent at the year end, it will generally be required to prepare consolidated financial statements. An entity will need to reappraise its investments in the light of different definitions of subsidiaries, associates and jointly controlled entities. An entity should also review the requirement to prepare consolidated financial statements and the exclusions that exist, as well as the additional requirements and exemptions available on transition.

FRS 102.9.2 -12,
FRS 102.14.2,
FRS 102.15.2-3,
FRS 102 35.9 (a), (f), (r)

Individual and separate financial statements

The term 'separate financial statements' is used in FRS 102 to describe the 'individual financial statements' of a parent. Of itself, the difference in terminology does not give rise to any differences in accounting treatment or disclosures.

FRS 102.9.23A,-24,9.26
FRS 102.35.10(f)

Part of a larger group

When an entity is part of a larger group, in addition to the consideration of consistent accounting policies, the date of adoption of FRS 102 throughout the group may have implications for the adjustments to be made on transition and the exemptions available.

FRS 102.35.10(r)

Determining the group structure and basic requirements

Entities need to determine whether they will be preparing consolidated financial statements and the accounting treatment for any interests in other entities in both the individual and consolidated financial statements, if required.

Interests in other entities will need to be reviewed to consider whether they meet the definitions of a subsidiary, associate, jointly controlled entity or Special Purpose Entity (SPE) in accordance with FRS 102. For any investment classified as a subsidiary, the entity should determine whether it meets any of the conditions in FRS 102 that would result in it being excluded from consolidation.

FRS 102.9.4 -6A, 9.9,9.11
FRS 102.14.2-3
FRS 102.15.2-3

Subsidiaries, associates and jointly-controlled entities that are held as part of an investment portfolio ie, held directly or indirectly as part of a basket of investments, are measured at fair value with changes recognised through profit or loss (FVTPL), and excluded from consolidation/equity accounting.

FRS 102.9.9B
FRS 102.14.4B
FRS 102.15.9B

When the entity is itself a subsidiary, associate or jointly controlled entity, consideration should be given as to whether its parent, or an ultimate parent, prepares consolidated financial statements and the accounting framework applied.

When consolidated financial statements are prepared by a parent or ultimate parent, the entity may be eligible for certain exemptions. Firstly, the entity may be exempted from the requirement to prepare group accounts. This exemption is also available if the entity, and the group headed by it, qualifies as small in accordance with the Companies Act 2006. Secondly, if the entity meets the definition in FRS 102 of a 'qualifying entity' it may take advantage of certain disclosure exemptions in its individual financial statements.

FRS 102.9.3
FRS 102.1.8-13

Meeting the requirements of FRS 102

- Review existing interests in other entities to consider whether the parent has control, joint control or significant influence.
- If the entity is a parent, consider whether it is exempt from preparing consolidated financial statements, for example when it is itself a subsidiary of a larger group.
- When no exemption from preparing consolidated financial statements applies, consider whether there are any grounds for exclusion of a subsidiary from consolidation, for example an investment that is held as part of an investment portfolio.

Section 6

Financial instruments – general

Overview

One of the greatest challenges facing first-time adopters of FRS 102 is likely to be the application of the requirements in respect of financial instruments. The definition is far-reaching, and changes to classification and measurement may have a significant impact on the balance sheet, distributable profits and compliance with the terms of legal agreements, for example bank covenants.

FRS 102.11.1

Further faculty factsheets
The factsheet *FRS 102: Financial Instruments* provides further guidance on Sections 11 and 12 of FRS 102.

Only for financial instruments do you have a choice of whether to apply the requirements of IFRSs as opposed to the requirements contained in FRS 102 (see below). There are other significant choices to be made too, for example designating an instrument to be measured at fair value through profit or loss or using hedge accounting, but an informed decision can be made only when you have identified the financial instruments in your business, considered their terms and their classification under FRS 102.

Practical tip: early identification of financial instruments

Make sure that contracts and agreements are reviewed to identify all financial instruments within your business at the earliest possible stage, including contracts such as derivatives that may not have previously been recognised on-balance sheet. Fair values are used extensively in the measurement of certain financial instruments and this information is gathered more easily at or close to the time of transition than at a later date.

Accounting policy – general

All financial instruments are accounted for using either:

FRS 102.11.2

- Sections 11 and 12 of FRS 102 in full; or
- The recognition and measurement provisions of IAS 39 as adopted for use in the EU together with the disclosure requirements of Sections 11 and 12 of FRS 102; or
- The recognition and measurement provisions of IFRS 9 (notwithstanding that it has not yet been adopted for use in the EU) and/or IAS 39 (amended by IFRS 9), together with the disclosure requirements of Sections 11 and 12 of FRS 102.

Practical tip: choosing to apply the requirements of IAS 39 and/or IFRS 9

The option to apply the recognition and measurement requirements of IAS 39 and/or IFRS 9 instead of the equivalent requirements of sections 11 and 12 of FRS 102 may be an attractive option for some, particularly for those with more complex financial instruments or entities that are part of a group preparing IFRS consolidated accounts.

The most appropriate choice for the individual entity will depend on the facts and circumstances.

The options to apply all or part of IAS 39 and/or IFRS 9 are not considered further in this factsheet.

Recognition of financial instruments

Financial assets and financial liabilities are recognised only when the entity becomes party to the contractual provisions of the instrument.

FRS 102.11.12

Classification of financial instruments

FRS 102.11.5-11

FRS 102 divides financial instruments into 'basic and 'other' instruments. Section 11 of FRS 102 sets out the criteria to meet for financial instruments to be classified as basic and gives limited examples. Those financial instruments that fail to meet the criteria will be classified as other.

The classification will have a direct impact on the required accounting treatment, with basic instruments mostly measured at amortised cost and other instruments mostly measured at fair value with movements recognised in profit or loss.

Practical tip: keep contract terms basic when possible

Make sure all staff with responsibilities for negotiating contracts on behalf of the organisation, from sales and trade purchases to financing arrangements, are aware of the potential pitfalls associated with any unusual contract terms. It may be helpful to draw up a list of issues that need consideration or ensure prior approval before contracts are completed.

Overview of classification and measurement

Below are examples of the types of financial instruments and the accounting treatment for those adopting the requirements of Sections 11 and 12 of FRS 102. The examples are for illustrative purposes only and individual facts and circumstances will need to be considered to determine the appropriate classification in light of the wording of the standard.

Financial instruments which form part of a hedging relationship are considered separately in section 7.

Illustrative examples – basic and other financial instruments

Instrument	Example(s)	Classification	Initial measurement	Subsequent measurement	Comment
Investment in shares (excluding shares in subsidiaries, associates and jointly controlled entities)	100 ordinary shares X plc	Basic	Cost +	Fair value through profit or loss (FVTPL)	When the fair value of the shares cannot be reliably measured, use cost less impairment. This should be rare.
Investment in debt with basic terms	100 UK gilts 4.5% 2019	Basic	Cost +	Amortised cost	Option to designate at FVTPL (see below)
Investment in debt with complex terms	100 convertible bonds Y plc	Other	Fair value ^	FVTPL	
Trade debtor		Basic	Cost +	Amortised cost	Measurement of debtors will usually be the invoiced price. However, when the arrangement is a financing arrangement measure at the present value of future payments.
Cash at bank	Current and deposit accounts	Basic	Cost +	Amortised cost	
Trade creditor		Basic	Cost +	Amortised cost	Measurement of creditors will usually be the invoiced price. However, when the arrangement is a financing arrangement measure at the present value of future payments.
Bank loan with basic terms	Bank loan repayable 2020 at LIBOR +1%	Basic	Cost +	Amortised cost	Option to designate at FVTPL (see below)
Bank loan with complex terms	Bank loan with interest payments linked to the UK Land Registry House Price Index +3%	Other	Fair value ^	FVTPL	
Derivatives*	Interest rate swap or forward foreign currency contract	Other	Fair value ^	FVTPL	

+ Cost at initial recognition will be the transaction price; this will include transaction costs except in the initial measurement of financial assets and liabilities that are measured at FVTPL.

FRS 102.11.13

^ Fair value at initial recognition will usually be the transaction price; this will include transaction costs except in the initial recognition of financial assets and liabilities that are measured at FVTPL.

FRS 102.12.7

* Derivatives that form part of a hedging relationship are considered separately in section 7 of this factsheet.

For a debt instrument to be classified as basic it must meet the conditions set out paragraph 11.9 of FRS 102. These criteria were relaxed when the standard was amended in July 2014. As a consequence of this change, more debt instruments will now be measured at amortised cost rather than at fair value. However the classification remains rules-based and so the requirements of paragraph 11.9 need careful consideration.

FRS 102.11.9

Practical tip: basic and other debt instruments

While paragraph 11.9 can sometimes be hard to decipher, the examples that immediately follow it are helpful as they illustrate how the criteria should be applied to a number of commonly encountered debt instruments.

Practical tip: classification of intercompany loans

There are no special requirements for loans between group companies ie, the normal requirements of paragraph 11.9 apply. Although many intercompany loans will meet the criteria to be classified as basic instruments, classification as such should not be assumed without a thorough analysis of all contractual terms.

In many cases intercompany loan agreements will not be formally or thoroughly documented. Entities may wish to formalise or clarify the terms of such arrangements on transition. Doing so will help to establish whether such instruments should be classified as basic or other. It will also create documentation to support this classification.

Option to designate debt instruments at fair value

A debt instrument may be designated at FVTPL at initial recognition, provided so doing provides more relevant information. Such circumstances would include when the use of a fair value avoids an accounting mismatch, or when an instrument is part of a group that is managed and its performance evaluated by reference to fair value.

FRS 102.11.14(b)

Exceptions and exemptions available on transition – classification

When an entity wishes to designate certain financial instruments as at FVTPL, it can do so as at the date of transition to FRS 102 provided the instrument(s) meets the criteria at that date.

FRS 102.35.10(s)

Meeting the requirements of FRS 102 – classification

- Review contracts extant at the transition date for potential financial assets and financial liabilities not recognised under the previous GAAP which may require recognition under FRS 102.
- Review contract terms of debt instruments and compare them to the criteria set out in paragraph 11.9 of the standard to establish whether they will be classified as basic or other, for example consider:
  - The rate of return over the life of the instrument and how this is quantified;
  - Provisions which could result in the lender losing the amount of the principal or any accrued interest;
  - Provisions linked to a contingent future event that would allow the borrower or the lender to request repayment before maturity; and
  - Other relevant contractual provisions.

FRS 102.11.3

Accounting treatment – measurement of basic financial instruments

Initial measurement

Financial assets and financial liabilities (other than financing transactions) are measured initially at the transaction price. Transaction price includes transaction costs except for financial instruments that are measured at FVTPL.

FRS 102.11.13

Financing transactions (eg, where payment is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate) are measured initially at the present value of future payments.

Practical tip: intercompany loans at zero or below market rates

As noted above, many intercompany loans are likely to be basic financial instruments. As such they will generally be measured at amortised cost.

For a loan with fixed maturity (that cannot be prepaid early) at zero or below market interest rates, the application of the standard will mean that it will be recorded on initial recognition at less than its nominal amount. This difference will generally be accounted for as a capital contribution or distribution.

Subsequent measurement

Basic debt instruments and financing transactions are measured at amortised cost unless designated at FVTPL. FRS 102.11.14

Investments in shares (excluding investments in subsidiaries, associates or jointly controlled entities) are measured at FVTPL unless it is not possible to estimate fair value reliably, in which case the investment will be measured at cost less impairment.

Practical tip: investments in shares

One of the major differences between current UK GAAP and FRS 102 is the measurement of many investments in shares at FVTPL. Entities need to gather the fair value information in a timely manner and consider the implications of any revaluation surplus or deficit on the financial statements and beyond, for example tax calculations and distributable profits.

Financial assets not measured at FVTPL must be assessed for impairment or uncollectability on an on-going basis.

Determining fair value

FRS 102 sets out a hierarchy to be followed to estimate the fair value of a financial instrument. This broadly works as follows: FRS 102.11.27-32

- The best evidence is a quoted price for an identical asset in an active market.
- The next-best evidence is the price of a recent transaction for an identical asset, adjusted to reflect different circumstances if necessary.
- When no active market exists, or recent transactions on their own are not a good estimate of fair value, a valuation technique should be used.

Exceptions and exemptions available on transition – measurement of basic financial instruments

None.

Meeting the requirements of FRS 102 – measurement of basic financial instruments

- Review contracts for evidence of arrangements which may be considered to be financing transactions, for example a sale of goods or services when payment is deferred beyond the normal business terms or loans at a non-market rate of interest (eg, an intra-group loan). For any financial assets and liabilities to be discounted, obtain evidence of a market interest rate for a similar instrument. FRS 102.11.13
- For any debt instrument measured at amortised cost, determine the initial cost, including transaction costs, the effective interest rate, payments made or received, and the cumulative amount amortised at the date of transition. FRS 102.11.14 (a)
- For any debt instruments to be designated as at FVTPL, obtain evidence to support the assertion that the classification provides more reliable information, together with reliable evidence to support the measurement of fair values. FRS 102.14 (b)
- For all financial assets measured at cost or amortised cost, consider any possible evidence of impairment or uncollectability before or at the transition date. FRS 102.11.15 (d)
- Obtain market values for investments in shares that are publicly traded. When shares are not publicly traded, identify other potential sources of evidence that may be used in establishing a reliable estimate of fair value in accordance with the fair value hierarchy. FRS 102.11.14 (d), 11.27-32

- When it has not been possible to find evidence to estimate the fair value of investments, confirm the original cost, including transaction costs, and consider whether any possible impairment indicators arose subsequent to the acquisition of the shares but prior to transition.

FRS 102.11.13, 14 (d)

Accounting treatment – measurement of other financial instruments

Financial instruments classified as other are measured at FVTPL except for:

FRS 102.12.8

- investments in equity instruments when the fair value cannot be measured reliably:
- hedging instruments that are part of a designated cash flow hedge; and
- instruments that cannot legally be measured at FVPTL.

Practical tip: instruments that cannot legally be measured at FVPTL

The Companies Act 2006 limits the circumstances in which certain financial liabilities can be measured at fair value. There is considerable debate about when and to what instruments this restriction applies. However, there is agreement that instruments that are subject to this restriction are likely to be extremely rare in practice.

Exceptions and exemptions available on transition – measurement of other financial instruments

None.

Meeting the requirements of FRS 102 – measurement of other financial instruments

Obtain market values for financial instruments classified as other that are publicly traded. When instruments are not publicly traded, identify other potential sources of evidence that may be used in establishing a reliable estimate of fair value in accordance with the fair value hierarchy.

FRS 102.12.8, 11.27-32

Derecognition of financial instruments

Financial assets

Financial assets are derecognised when the contractual rights to the cash flows from the financial assets expire or are settled, or the risks and rewards of ownership have been substantially transferred. When some of the risks and rewards of ownership are retained but control has been transferred to another party, the asset is derecognised and any rights and obligations retained or created are recognised separately.

FRS 102.11.33 -35
FRS 102.12.14

Financial liabilities

Financial liabilities are derecognised only when the liability is extinguished ie, when the obligation specified in the contract is discharged, is cancelled or expires. When financial liabilities are renegotiated with substantially different terms, the original liability is extinguished and a new liability recognised.

FRS 102.11.36-38
FRS 102.12.14

Exceptions and exemptions on transition

Financial instruments derecognised under an entity's previous GAAP before the date of transition are not recognised on adoption of FRS 102.

FRS 102.35.9(a)

Financial instruments that were not derecognised under an entity's previous GAAP in a transaction that took place before the date of transition, but that would have been derecognised under FRS 102 may be:

- Derecognised on adoption of FRS 102; or
- Kept on the balance sheet until they are disposed of or settled.

Practical tip: modification of loan arrangements

Entities renegotiating the terms of bank loans will need to take care as if the terms of the arrangement are substantially modified this will result in the extinguishment of the original financial liability and the recognition of a new financial liability with the difference between the carrying amount of the financial liability extinguished and the consideration paid being recognised in profit or loss. The standard does not, however, define 'substantially modified' so judgement will be needed when determining the appropriate accounting treatment.

When bank loans have been renegotiated under substantially different terms prior to the transition date, but not derecognised and a new liability recognised, the entity may apply the exemption in FRS 102.35 to retain this treatment on transition. However, this exemption does not apply if these renegotiations take place after the transition date, say in 2014. In such instances the comparative balance sheet will have to be restated.

Section 7

Financial instruments – hedging

Overview

Many entities engage in hedging activities to manage the risks they face. Common examples include entering into forward contracts to manage exposures to exchange rate movements or using interest rate swaps to manage exposures to interest rate movements though some entities will be involved in more complex hedging transactions.

When an entity enters into a hedging transaction it uses a hedging instrument (which is typically a derivative) to manage an exposure arising from a hedged item. The idea is that gains or losses on the hedging instrument will offset, to varying degrees, gains or losses on the hedged item. However, under FRS 102's normal accounting rules, these gains and losses on the hedged item and hedging instrument can end up being recorded in profit or loss in different accounting periods, resulting in earnings volatility. The standard therefore allows entities to reduce this volatility – and better reflect their risk management processes – by applying special hedge accounting rules provided certain criteria are met.

Practical tip: a very different approach to hedging

Some accounting treatments which may have been the norm under the previous GAAP will no longer be acceptable under FRS 102. For example, when the entity has entered into a forward foreign currency contract to match a trading transaction, under the previous GAAP this forward rate may have been used to translate the transaction and the related debtor or creditor. This policy is no longer acceptable as FRS 102 requires the transaction to be recorded at the spot rate and the debtor or creditor at the closing rate. The forward currency contract is accounted for separately at FVTPL. Similarly, interest rate swaps previously accounted for on a settlement basis will now appear on-balance sheet at FVTPL. Entities will need to ensure that all derivative contracts existing on or around the transition date are identified and gather the appropriate fair value information.

Changes to FRS 102's hedging requirements

The original version of FRS 102 defined a narrow set of permitted arrangements that could qualify for hedge accounting. However, it was always the FRC's intention to update these requirements once the IASB had finalised its new hedge accounting requirements.

In July 2014, the IASB issued a final version of IFRS 9, including its new hedge accounting requirements. The FRC consequently made amendments to Section 12 of FRS 102 to reflect these new requirements, removing the restrictions described above and making hedge accounting more readily available to entities where it is consistent with their risk management strategies. The text that follows reflects the revised version of FRS 102 that incorporates these changes.

Practical tip: groups of items, components of an item and net exposures

The amendments to Section 12 of FRS 102 not only make it easier for individual items to qualify as hedged items but also for the first time allow groups of items and components of an item to be eligible hedged items provided certain criteria are met. However, net exposures cannot be eligible hedged items.

Qualifying for hedge accounting

FRS 102.12.18, 12.18A

An entity may apply hedge accounting to a hedging relationship provided all of the following conditions are met:

- the hedging relationship consists only of a hedging instrument and a hedged item that meet certain criteria;
- the hedging relationship is consistent with the entity's risk management objectives for undertaking hedges;
- there is an economic relationship between the hedged item and the hedging instrument ie, the entity expects that the values of the hedged item and hedging instrument will typically move in opposite directions in response to the same risk, which is the hedged risk;
- the entity has documented the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified; and
- the entity has determined and documented causes of hedge ineffectiveness.

FRS 102.12.19

FRS 102 recognises three types of hedging relationships: fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation.

Accounting treatment

FRS 102.12.19 -24

How the hedging relationship will be reflected in the financial statements will depend on the nature of the hedged risk.

For example, the effective portion of a fair value adjustment on a hedging instrument used to hedge the commodity price risk in a highly probable future transaction will initially be recognised in other comprehensive income (OCI) as opposed to profit or loss. The cumulative gain or loss on the hedging instrument recognised in the cash flow hedge reserve will typically be reclassified from equity to profit or loss or added to the cost of any subsequently acquired asset or liability as appropriate when the highly probable forecast transaction takes place,. This is referred to in FRS 102 as a cash flow hedge.

Alternatively, when a hedging instrument has been used to hedge the price risk of a commodity that the entity holds, the asset is restated to reflect the fair value of the hedged risk, with the change in fair value and the fair value adjustment on the hedging instrument both recognised through profit or loss. This is referred to in FRS 102 as a fair value hedge.

Hedges of a net investment in a foreign operation are accounted for similarly to cash flow hedges, with the effective portion of the fair value adjustment on the hedging instrument recognised in OCI as opposed to profit or loss. However, these gains or losses are not reclassified from equity to profit or loss on disposal or partial disposal of the foreign operation.

An appendix to Section 12 also includes a number of useful numerical examples of hedge accounting.

Practical tip: current trading transactions matched by forward contracts

When the entity has entered into a forward currency contract to hedge the risk of a recognised debtor or creditor balance (eg, arising from a sale or purchase) at the date the debtor or creditor is first recognised, the standard accounting treatment under FRS 102 will usually ensure no accounting mismatch arises. The debtor or creditor will be translated at the closing rate with any exchange difference recognised in profit or loss, and the related forward currency contract will be measured at FVTPL. Therefore, there is no need to designate or document the hedging relationship as the treatment of the hedging instrument and the hedged item are already matched.

Discontinuing hedge accounting

An entity may voluntarily discontinue hedge accounting provided it has documented its election.

FRS 102.12.25, 12.25A

An entity must discontinue hedge accounting when:

- the hedging instrument has expired, is sold, terminated or exercised; or
- the conditions for hedge accounting described above are no longer met.

In all cases, hedge accounting is discontinued prospectively. The accounting treatment will depend on the nature of the hedge and the circumstances of the discontinuance.

Exemptions available on transition

A first-time adopter can choose to apply hedge accounting to an eligible hedging relationship which exists on the date of transition provided the first three conditions outlined at the top of page 20 of this factsheet are met on the date of transition and the remaining two conditions are met no later than the date the first financial statements that comply with FRS 102 are authorised for issue. Significantly, hedging documentation does not have to be in place at the date of transition.

FRS 102.35.10(t)

A similar exemption is available for hedging relationships that commence after the date of transition.

Practical tip: hedge documentation

To meet the hedge accounting requirements for hedging arrangements existing at the transition date, FRS 102 as originally issued was sometimes interpreted as requiring that the hedging relationship be designated and documented at the transition date. Moreover, there were no specific exemptions to the standard's transition requirements.

However, the amendments made to the standard in July 2014 introduce a new exemption that allows entities to apply hedge accounting to such arrangements provided that the documentation is in place by no later than the date the first financial statements that comply with FRS 102 are authorised for issue. The same timeframe applies to documenting hedging relationships that commenced after the date of transition.

This means that entities will now have up to 33 months after their transition date to create their hedge documentation.

A first-time adopter may also elect not to adjust the carrying amount of an asset or liability for previous GAAP accounting effects of a hedging relationship that has ceased to exist before the date of transition because the hedging instrument has expired, was sold, terminated or exercised prior to the date of transition.

Entities will need to consider carefully the potential impact of choosing whether or not to take advantage of these exemptions.

Meeting the requirements of FRS 102

- Identify any qualifying hedging relationships that exist at the transition date or have commenced since then and any documentation available to evidence the economic relationship between the hedging instrument and the hedged item. (FRS 102.12.18)
- Ensure hedge documentation is in place by no later than the date the first financial statements that comply with FRS 102 are authorised for issue. (FRS 102.35.10(t)(i) and (iii))
- Determine whether any hedging relationships that ceased to exist before the transition date have been accounted for using hedge accounting under the previous GAAP and decide whether to take advantage the of the election not to adjust the carrying amount of related assets or liabilities. (FRS 102.35.10(t)(ii))

Section 8

Major changes affecting most entities

Introduction

The impact on the financial statements of moving to FRS 102 will vary from entity to entity. However, there are likely to be some areas of significant change that affect most entities, some areas of significant change that affect a few entities, and some areas in which there will be little or no change for most entities. The next three sections of this factsheet have been structured to reflect this. This section considers the new requirements that – as well as financial instruments (see above) – are most likely to have a significant effect on most entities.

Lease incentives

Accounting treatment

FRS 102.20.15A

Lease incentives are allocated over the lease term ie, the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has an option to continue to lease when at the inception of the lease it is reasonably certain that the lessee will exercise that option.

Exceptions and exemptions on transition

FRS 102.35.10(p)

When a lease term commenced before the date of transition, a lease incentive may continue to be recognised as required by the previous GAAP.

Practical tip: tax implications of exemption

The accounting treatment under FRS 102 contrasts with current UK GAAP which requires the incentive to be allocated over the **shorter** of the lease term and the period ending on the date from which it is expected the prevailing market rental will be payable. The decision to take the exemption to restate lease incentives or not will have a direct impact on your accounting profits. As a result, this may also have an impact on your taxable profits for the period.

Meeting the requirements of FRS 102

When the entity has **not** selected the exemption available on transition to continue with the previous treatment, or has leases entered into after the date of transition, it will need to identify the nature of the lease incentive and establish the length of the lease term as described above to determine the appropriate amortisation rate for the incentive.

Employee benefits

Accounting treatment

FRS 102.28.3

There are no accounting policy choices in respect of employee benefits. The entity must recognise the cost of all employee benefits to which the employees have become entitled as a result of services rendered. This includes all short-term benefits such as wages and salaries and any additional benefits, as well as post-employment benefits such as pensions.

Exceptions and exemptions on transition

None.

Meeting the requirements of FRS 102

- Obtain evidence of the different forms of employee benefits to ensure that a process is in place to identify any necessary accruals, for example holiday-pay (accumulating compensated absences).

Practical tip: holiday pay accrual

Any entities that have not recorded a holiday accrual in the past will need to consider whether an accrual will be necessary on first-time adoption of FRS 102. If such an accrual is required, it is important that adequate records are maintained to enable calculations to be performed.

- Consider whether there are any agreements to terminate employment of employees that give rise to liabilities.
- When the entity operates defined contribution plans on behalf of its employees, ensure that an accrual or prepayment is identified as appropriate.
- When the entity has defined benefit plans ensure that a valuation in accordance with the requirements of FRS 102 of the plan assets and liabilities will take place at the transition date.

Practical tip: valuation of defined benefit plans

Entities that have previously applied FRS 17 should see little or no difference in the valuation of the plan assets or liabilities. However, the calculation and presentation of the movement in the defined benefit plan will change and revised numbers may therefore be required from the actuary for the comparative period.

- When the entity participates in a defined benefit plan which is a multi-employer plan and is accounted for as a defined contribution plan, determine to what extent the entity is liable to fund any deficit in the plan. Group benefit plans are separate from multi-employer plans (see below).

Practical tip: implications of an agreement to fund a deficit in a multi-employer plan

If there is an agreement to fund a deficit in a multi-employer plan, the entity will need to calculate and recognise the net present value of the committed payment.

- For group benefit plans, confirm whether there is a stated policy for charging the net defined benefit cost to the individual entities in the group. If no stated policy exists, confirm the amounts payable by the individual entity in the period and identify the group entity that is legally responsible for the plan and will need to recognise the net defined benefit cost.

Practical tip: stated policy for group defined benefit plans

When there is a contractual agreement or stated policy in place for charging the net defined benefit
cost of a group defined benefit plan to individual group entities, the accounting treatment will follow the terms of the contractual agreement or policy. When no such agreement exists, the net defined benefit cost will be recognised in the individual financial statements of the group entity that is legally responsible for the plan, usually the parent. The other group entities will recognise a cost equal to their contribution payable for the period in their individual financial statements. Putting an agreement in place by the transition date will therefore have a direct impact on how the net defined benefit cost is allocated between the individual entities in the group. This change in accounting in the individual financial statements may have an impact on distributable reserves for the companies concerned.

Tax

Accounting treatment

There is no accounting policy choice. An entity must recognise a current tax liability for any current tax payable and any current tax asset that can be recovered. Deferred tax is recognised on timing differences, that is differences between taxable profits and total comprehensive income. Deferred tax assets are recognised only to the extent that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

FRS 102.29. 3-10

Deferred tax is also recognised in respect of assets (other than goodwill) and liabilities recognised in a business combination that differ from the amount that may be deducted for tax for an asset or assessed for tax for a liability,

FRS 102.29.11

Practical tip: additional provisions for deferred tax

The increased use of fair values and the requirement to provide for deferred tax on differences between taxable profits and total comprehensive income is likely to result in higher deferred tax provisions than under current UK GAAP. For example, deferred tax will now be required on revaluations, including investment properties and fair value adjustments.

Exceptions and exemptions on transition

None.

Meeting the requirements of FRS 102

- Obtain current tax computations, confirm estimated date of payment (or receipt) and the tax rates enacted or substantively enacted at the transition date which correspond to the expected cash flows.
- Ensure that all timing differences, including revaluations that took place prior to transition and adjustments on transition, are identified and the potential deferred tax consequences considered.
- If the deferred tax calculations result in a deferred tax asset, consider to what extent it can be recovered against the reversal of other deferred tax liabilities or future taxable profits.

Section 9

Major changes affecting some entities

Introduction

This section of the factsheet considers those requirements of FRS 102 that are likely to have a significant impact but only for some entities.

Investment property

Accounting treatment

Investment properties are generally measured to fair value at each reporting date, with changes in fair value recognised in profit or loss. However, when a reliable measure of fair value is not available without undue cost or effort the investment property will be accounted for as PPE using the cost model.

FRS 102.16.7

Practical tip: reliable measure of fair value

A reliable measure of fair value will generally be available for properties within the UK, given a well-established valuation profession. Therefore, it appears that only in rare circumstances will investment properties be accounted for as PPE using the cost model.

Property held under an operating lease may be classified as investment property if the property would otherwise meet the definition of an investment property and the lessee can measure the fair value of the property without undue cost or effort on an on-going basis. When a property is held under a lease and classified as an investment property the lease must be accounted for as a finance lease ie, a liability will be recognised. This choice is available on a property-by-property basis.

FRS 102.16.3, 6

Practical tip: investment properties held let within the group

In the individual financial statements of the lessor company, investment properties let to and occupied by another group company are not excluded from the definition of an investment property. A valuation at transition date will therefore need to be obtained if the property has previously been accounted for under the cost model for PPE.

Exceptions and exemptions on transition

The fair value of the asset at the date of transition or a previous GAAP revaluation at, or before, the date of transition may be used as its deemed cost. This exemption is relevant only for investment properties measured at cost (see above).

FRS 102.35.10(c) – (d)

Practical tip: using deemed cost

As noted in section 4 of this factsheet, using deemed cost has disclosure and other implications (eg, deferred tax). It is also recommended that valuations are requested as close as possible to the transition date.

Meeting the requirements of FRS 102

- Check that property classified as investment property at the transition date includes:
  - all property that is owned or leased under a finance lease with the objective of earning rentals or for capital appreciation or both;
  - property held under an operating lease that is to be classified as investment property (see above);
  - the investment property component of mixed use property (unless the fair value of the investment property component cannot be measured reliably without undue cost or effort).

FRS 102.16.1-4

- Obtain evidence of the fair value at the transition date or a previous GAAP valuation for any items of investment property for which the exemption is to be used.

FRS 102.35.10(c)-(d)

- When the exemption is not applied, obtain reliable evidence to support the fair value at the transition date. When no reliable estimate of fair value is available, confirm the amounts are correctly identified in accordance with Section 17 on PPE (see below).
- For any asset held at fair value ensure a provision is recognised for any deferred tax.

FRS 102.16.5-7

Property, Plant and Equipment

Accounting treatment

Entities may choose to measure all items of property, plant and equipment (PPE) using the cost model or the revaluation model. If a revaluation model is adopted, it must be applied to all assets in the same class.

Borrowing costs may be capitalised as part of the cost of the asset subject to the recognition criteria being met. When an entity adopts a policy of capitalisation, this must be applied consistently to all qualifying assets in that class (see below).

FRS 102.17.10(d)
FRS 102.25.2

Exceptions and exemptions on transition

The fair value of an item of PPE at the transition date or a previous GAAP revaluation at, or before, the transition date may be used as its deemed cost.

FRS 102.35.10 (c), (d)

Practical tip: using deemed cost

As noted in section 4 of this factsheet, using deemed cost has disclosure and other implications (eg, deferred tax). It is also recommended that valuations are requested as close as possible to the transition date.

Any decommissioning liabilities to be included in the cost of an item of PPE may be measured at the time of transition, as opposed to the date when the obligation initially arose.

Meeting the requirements of FRS 102

- Obtain a listing of the PPE held by the business to confirm that assets have been correctly classified, for example spare parts and servicing equipment are classified in accordance with the standard (ie, as inventory or as part of PPE as appropriate) and land and buildings are treated as separable assets.
- For assets held at cost, confirm that cost includes the purchase price, any directly attributable costs and any estimated decommissioning costs.
- When costs include replacement amounts eg, the roof of a building, obtain evidence that the replacement amount provides incremental benefits and the carrying amount of the parts replaced have been derecognised.
- Confirm the details of any interest capitalised in accordance with Section 25 (see section 10 of this factsheet).
- Obtain evidence of the fair value at the transition date or a previous GAAP valuation for any items of PPE for which the exemption is to be used.
- When the major components of an item of PPE have significantly different patterns of consumption of economic benefits, ensure that the carrying values of those components are separately identifiable for depreciation purposes.
- Obtain evidence of residual values to be used in the depreciation calculation based on the amount the entity would currently obtain from the disposal of the asset if the asset were already at the age and condition expected at the end of its useful life.
- Confirm the cumulative depreciation and impairments based on the facts and circumstances that existed at the transition date.
- When an accounting policy of measuring items of PPE at valuation is to be adopted, obtain details of the valuation including information required for disclosure purposes at the transition date.
- For any asset held at fair value or deemed cost ensure that any gain or loss is recognised in a separate revaluation reserve and a provision is recognised for any deferred tax.

FRS 102.17.5, 10, 15,16,18
FRS 102.25.2

Intangible fixed assets other than goodwill[3]

Accounting treatment

Entities may choose to adopt an accounting policy of capitalising deferred development expenditure if specified criteria are met; that policy must be applied consistently to all expenditure that meets the requirements.

FRS 102.18.8H

Borrowing costs may be capitalised as part of the cost of an internally generated intangible asset subject to the capitalisation criteria being met. When an entity adopts a policy of capitalisation, this must be applied consistently to all qualifying assets in that class (see below).

FRS 102.18.10(B)
FRS 102.25.2

In exceptional cases intangibles may be measured using a revaluation model.

FRS 18.18(B)

Exceptions and exemptions on transition

For intangible assets that meet the recognition and revaluation criteria in Section 18, the fair value at the transition date or a previous GAAP revaluation at, or before, the transition date may be used as its deemed cost.

FRS 102.35.10 (c), (d), (o)

The carrying amount of development expenditure deferred in accordance with SSAP 13 *Accounting for research and development* may be used as deemed cost on transition.

FRS 102.35 (n)

Practical tip: using deemed cost

As noted in section 4 of this factsheet, using deemed cost has disclosure and other implications (eg, deferred tax). It is also recommended that valuations are requested as close as possible to the transition date.

Meeting the requirements of FRS 102

- Identify those intangibles that are separable or arise from contractual or legal rights.

FRS 102.18.2,4, 8C, 8E, 8H, 9, 29A

Practical tip: recognition of more intangibles on balance sheet

The fact that FRS 102 requires recognition of intangibles that are separable (ie, capable of being disposed of separately from the entity) **or** arise from either contractual or legal rights may result in more intangibles being recognised on balance sheet. Under current UK GAAP intangible assets are recognised only when they are separable **and** controlled by the entity through custody or legal rights.

- Confirm that no internally generated intangibles are included other than development expenditure when a policy of deferring development expenditure has been adopted.
- Obtain evidence of the fair value at the transition date or a previous GAAP valuation for any intangibles for which the exemption is to be used. Otherwise confirm the original cost.
- Confirm the carrying value of deferred development expenditure in accordance with SSAP 13 at the transition date when the exemption is to be used. Otherwise confirm the costs to be included meet the conditions in the standard.
- Assess the probability of the future economic benefit of the assets and consider any evidence of impairment indicators that have arisen prior to the transition date.
- Establish the estimated remaining useful life of the intangibles at the transition date and obtain reliable evidence when an estimated useful life exceeding five years is to be used.

FRS102.18.8A-K

Practical tip: amortisation of intangibles

When intangibles have previously been tested for impairment and not amortised, a remaining useful life will need to be established at the transition date. When the total estimated useful life of the intangible is estimated to be in excess of five years, reliable evidence will be required to support the estimated total useful life and the remaining useful life at transition.

[3] For intangible assets acquired as part of a business combination, entities can elect not to restate any business combinations that were effected before the date of transition. Therefore these intangibles will usually continue to be subsumed within goodwill. For more information see below.

Interests in subsidiaries, associates and jointly controlled entities – individual financial statements

Accounting treatment

A parent can choose to account for subsidiaries, associates and jointly controlled entities in its separate financial statements at either:

FRS 102.9.26

- cost less impairment (the cost model);
- fair value with changes in fair value recognised in other comprehensive income; or
- fair value with changes recognised in profit or loss.

The same accounting policy must be applied to all investments in a single class.

Exceptions and exemptions on transition

When the cost model is applied, the carrying amount of an investment in a subsidiary, associate or jointly controlled entity at the date of transition as determined under the previous GAAP may be used as its deemed cost.

FRS 102.35.10(f)

Meeting the requirements of FRS 102

- Ensure all investments have been correctly classified. (FRS 102.9.4, 14.2-3, 15.2-8)
- Confirm the previous GAAP valuation when the exemption is to be applied on transition.
- For investments to be carried at cost, ensure that cost is measured in accordance with FRS 102 and check for any indicators of impairment prior to the transition date. (FRS 102.9.26)
- Check the evidence for any fair values to be used in the measurement of the investments and ensure that the fair value hierarchy has been used appropriately. (FRS 102.11.27-32)
- For interests in joint ventures that meet the definition of jointly controlled assets or jointly controlled operations, ensure that the share of assets and liabilities has been correctly identified and valued in accordance with FRS 102. (FRS 102.15.4-7)
- For any asset held at fair value ensure a provision is recognised for any deferred tax.

Investments in associates and jointly controlled entities – consolidated financial statements

Accounting treatment

All associates and jointly controlled entities are accounted for in the consolidated financial statements using the equity method, unless the investment in the associate or jointly controlled entity is held as part of an investment portfolio.

FRS 102.14.4A-B
FRS 102.15.9A-B

Exceptions and exemptions on transition

When an entity adopts FRS 102 later than its associate or jointly controlled entity, the application of the equity method must be based on the carrying amounts in the financial statements of the associate or jointly controlled entity.

FRS 102.10.35.(r)

Meeting the requirements of FRS 102

For investments in associates and jointly controlled entities accounted for using the equity method:

FRS 102.14.8
FRS 102.15.13

- Confirm the original transaction price, including transaction costs.
- Confirm the adjustments to the transaction price to reflect the investor's share of profit or loss, other comprehensive income and equity of the associate or jointly controlled entity at the date of transition.
- Identify any unrealised losses at the transition date to be eliminated from the consolidated financial statements.
- Consider whether there are any indicators of impairment in the carrying value of the investment in associate or jointly controlled entity that arose prior to the transition date.

Business combinations

Accounting treatment

FRS 102 requires acquisition accounting (referred to as the purchase method) for all business combinations within its scope. The only exception is for group reconstructions that may be accounted for using the merger method when certain criteria are met. FRS 102 also has very specific requirements regarding the identification and measurement of the subsidiary's assets and liabilities at the date of acquisition.

FRS 102.19.6

Goodwill arising on consolidation is measured at its cost (being the excess of the cost of the business combination over the acquirer's interest in the net amount of the identifiable assets, liabilities and contingent liabilities) less amortisation and impairment. The useful life of goodwill is considered to be finite and where a reliable estimate of its useful life cannot be made it must not exceed 5 years.

FRS 102.19.22-23

Negative goodwill is recognised as a negative asset and recognised in profit or loss over the periods expected to benefit.

Practical tip: intangible assets recognised separately from goodwill

As noted above, the definition of intangibles in FRS 102 is wider than in current UK GAAP and for business combinations the probability of future economic benefits is assumed. As a result, many more intangibles will be recognised separately from goodwill. This will also have deferred tax implications with additional liabilities being recognised.

However, there is no requirement to identify separately intangible assets arising on business combinations before the transition date if the exemption not to restate previous business combinations is selected (see below). Business combinations after the transition date will be affected.

As amortisation of all intangibles including goodwill is required, the entity will have to estimate the useful life of all intangibles recognised separately at transition.

Exceptions and exemptions available on transition

A first-time adopter of FRS 102 may elect not to apply Section 19 *Business Combinations* retrospectively to business combinations that occurred prior to the transition date. If Section 19 is applied retrospectively to any business combination, all later business combinations must also be restated.

FRS 102.35.10(a)

When the entity has selected the option not to restate earlier business combinations, intangible assets subsumed within goodwill must not be recognised separately and there must be no adjustment to the carrying value of goodwill at transition.

FRS 102.35.10(a)

The requirements:

FRS 102.35.9(e)

- to allocate profit or loss and total comprehensive income between the non-controlling interest and the owners of the parent;
- for accounting changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and
- for accounting for a loss of control over a subsidiary

are applied prospectively from the date of transition (or from the date of restatement of a business combination arising before transition).

Practical tip: difficulties of restatement

Applying FRS 102 retrospectively may well be challenging in many areas but perhaps none more so than in the area of business combinations. In particular the recognition of intangibles and arriving at fair values long after the acquisition date could prove extremely burdensome. The exemption available not to restate earlier acquisitions will therefore be an attractive option for many.

Illustrative example: restatement of earlier business combinations

Background

Barnet Ltd has a 31 December year end and will be adopting FRS 102 for the year ended 31 December 2015. Barnet Ltd has made the following acquisitions over the last few years:

Trim Ltd on 1 January 1995.

Perm Ltd on 1 January 2010

Tint Ltd on 1 January 2013

Barnet Ltd is on target to make a further acquisition of Style Ltd on 1 January 2014.

Options

Barnet Ltd could select the exemption not to restate any of the acquisitions prior to 1 January 2014 in accordance with Section 19. However, if it were to restate one of the acquisitions all later acquisitions must also be restated. For example, should Barnet Ltd decide to restate the acquisition of Perm Ltd it must also restate the acquisition of Tint Ltd.

The acquisition of Style Ltd must be accounted for in accordance with Section 19 if the acquisition takes place after the transition date as predicted.

Meeting the requirements of FRS 102

When the exemption is used and Section 19 of FRS 102 is not applied to business combinations that took place before the transition date:

- Check that a balance sheet is prepared, or will be prepared, for the acquired company as at the transition date in accordance with the recognition, classification and measurement requirements of FRS 102. FRS 102.9.17
- Confirm the amount of goodwill arising at the transition date is consistent with the previous GAAP; no adjustments are made for intangibles previously subsumed within goodwill or amortisation and/or impairments recognised prior to the transition date. FRS 102.35.10 (a)
- Obtain evidence for the estimated remaining useful life of goodwill at the transition date. FRS 102.19.23
- Identify any intra-group balances or unrealised profits to be eliminated on consolidation. FRS 102.9.15

Practical tip: no restatement of business combinations

As noted above, the option not to restate business combinations that occurred prior to the transition date will be attractive to many. However, it is important to remember that adjustments may still be required to ensure that all amounts to be consolidated apply the recognition, classification and measurement requirements of FRS 102. For example, even if an entity uses the business combinations exemption it may need to make adjustments to recognise some financial instruments for the first time or to include deferred tax on the difference between the carrying amount of an asset or liability recognised in a business combination and the amount that can be deducted for tax or assessed for tax (for example, on fixed assets revalued to fair value on acquisition). Further deferred tax provisions may also be required for unremitted earnings. Any adjustments arising will be taken to equity.

When the exemption is not used and the FRS 102 purchase method is applied:

- Check that the business combination that took place prior to the transition date meets the FRS 102 definition of a business combination. FRS 102.19.3-5
- When some but not all, business combinations have been restated to meet the requirements of FRS 102, check the dates of acquisition, identify the earliest business combination to be restated and ensure that all subsequent business combinations are also restated in accordance with Section 19 of FRS 102.
- Confirm that the parent company is the 'acquirer' ie, has control over the other entity. FRS 102.19.8-10
- Confirm that the cost of the combination is measured at the fair value of the consideration given, including the estimated amount of any probable contingent consideration and transaction costs. FRS 102.19.11-13
- Review the assets and liabilities identified at the acquisition date and identify any available reliable evidence to support the recognition and measurement of separately identifiable intangibles and contingent assets and liabilities. FRS 102.19.14-15C

- Establish the deferred tax asset or liability arising on the assets acquired and liabilities assumed.
- Obtain evidence of the useful life of any intangible assets and goodwill to establish an appropriate amortisation rate. When it is not possible to make a reliable estimate, the useful life must not exceed five years. FRS 102.19.23
- In the case of negative goodwill, reassess the measurement of the net assets acquired and the cost of acquisition. FRS 102.19.24
- Confirm that the accounting policies in the financial statements of the acquiree prepared for consolidation purposes are consistent with those of the group. FRS 102.9.17
- Identify any intra-group balances or unrealised profits to be eliminated on consolidation. FRS 102.9.15

Government grants

Accounting treatment

Government grants are recognised based on either the performance model or the accrual model. The policy must be applied consistently on a class-by-class basis. FRS 102.24.4

Exceptions and exemptions on transition

None.

Meeting the requirements of FRS 102

- For all government grants at the transition date check that they can be distinguished from normal trading transactions with the government and exclude those forms of government assistance that cannot reasonably have a value placed upon them. FRS 102.24.1-3
- Confirm that the grant has been received or there is reasonable assurance that it will be received and that the recipient entity will comply with the attached conditions. FRS 102.24. 3A
- Confirm that the grant is measured initially at the fair value of the asset received. FRS 102.24.5
- When the performance model is to be applied, identify the performance conditions and the extent to which these have been met before the transition date. FRS 102.24.5B
- When the accrual model is to be applied, identify the extent to which a grant relates to revenue or assets, and identify the extent to which the related expenses or depreciation have been recognised in profit or loss on transition. FRS 102.24.C-F
- Identify any grants that have become repayable and are therefore required to be classified as liabilities. FRS 102.24.5A

Foreign currency – individual company

Accounting treatment

An entity may present its financial statements in a currency other than its 'functional currency' (that is the currency of the primary economic environment in which it operates). FRS 102.30.2, 17

Otherwise there are no accounting policy choices. Monetary items are translated at the closing rate. Non-monetary items are translated at the rate at the date of the transaction unless the asset is measured at fair value, in which case the rate at the date of the valuation will be used. FRS 102.30.6-11

Exceptions and exemptions on transition

There are no exceptions or exemptions on transition.

Meeting the requirements of FRS 102

- Consider whether there is a difference between the entity's functional currency and its presentational currency. FRS 102.30.6-11
- Identify the exchange rates required at the transition date.
- Confirm that non-monetary items are translated at the historic rate unless the asset is measured at fair value.
- Identify the exchange rates required for any fair values to be used in the financial statements.

Practical tip: net investment in a foreign operation

Under current UK GAAP entities are permitted to treat certain long term loans and deferred intercompany trading balances as part of the net investment in a foreign operation and recognise any exchange differences in the Statement of Recognised Gains and Losses as opposed to the profit and loss account. FRS 102 requires the exchange differences to be recognised in profit or loss in the separate financial statements and therefore entities may wish to look again at the financing arrangements for foreign operations.

Foreign currency – consolidated financial statements

Accounting treatment

There is no accounting policy choice: the financial statements of the foreign operation are translated from the functional currency of the operation to the presentation currency to be used by the group.

FRS 102.30.17

Exceptions and exemptions on transition

None.

Meeting the requirements of FRS 102

FRS 102.30.17-23

- Confirm the functional currency of the operation is not the currency of a hyperinflationary economy.
- Confirm the applicable rate of exchange on the transition date.
- Confirm the carrying value of goodwill in the functional currency to be translated at the closing rate.

Practical tip: translation of goodwill and fair value adjustments at the closing rate

FRS 102 requires goodwill and fair value adjustments to be translated at the closing rate. This may differ from the current treatment as current UK GAAP does not specify the rate to be used and therefore many entities have translated goodwill and fair value adjustments at the rate ruling at acquisition. There are no transitional exemptions to this requirement.

FRS 102.31.1

- When the functional currency of the foreign operation is the currency of a hyperinflationary economy ensure financial statements adjusted for the effects of hyperinflation are prepared.

Section 10

Changes unlikely to have a major effect on most entities

Introduction

This section of the factsheet considers those requirements of FRS 102 that are unlikely to have a major effect on most entities. However, the implications of any of the requirements in FRS 102 need to be considered in the context of the entity's individual facts and circumstances.

Borrowing costs

FRS 102.25.2

Accounting treatment

Borrowing costs may be capitalised as part of the cost of a qualifying asset or may be recognised as an expense in profit or loss as incurred. When borrowing costs are capitalised, the policy must be applied consistently to a class of qualifying assets.

FRS 102.25.2

Exceptions and exemptions on transition

The transition date to FRS 102 may be treated as the date on which capitalisation of borrowing costs within the cost of a qualifying asset commences.

FRS 102.35.10(o)

Inventories

Accounting treatment

There is no accounting policy choice: all inventories, other than those held for distribution at no or nominal consideration, are measured at the lower of cost and net realisable value. Those inventories that are held for distribution at no or nominal consideration are measured at cost adjusted for any loss of service potential.

FRS 102.13.4-4A

Exceptions and exemptions on transition

Borrowing costs may be capitalised as part of the cost of inventory subject to the capitalisation criteria being met. When an entity adopts a policy of capitalisation, this must be applied consistently to all qualifying assets in that class.

FRS 102.13.7, FRS 102.25.2

Leases

Accounting treatment

There is no accounting policy choice in respect of leases. Finance leases are recognised by the lessee as assets and liabilities at the lower of fair value of the leased asset and the present value of the minimum lease payments. Operating leases are recognised by the lessee as an expense over the lease term on a straight line or other systematic basis.

FRS 102.20.9-12, 20.15

Exceptions and exemptions on transition

An entity may assess whether an arrangement, which exists at the transition date, contains a lease on the basis of facts and circumstances at the transition date rather than when the lease arrangement was entered into.

FRS 102.35.10 (k)

Construction contracts in the books of the seller

Accounting treatment

Construction contracts are accounted for on a percentage completion basis.

FRS 102.23.17

Exceptions and exemptions on transition

None.

Provisions and contingencies

Accounting treatment

There are no choices of accounting policy in respect of provisions. FRS 102.21.4-13

Provisions are recognised when the entity has an obligation as a result of a past event, when there are probable outflows of economic benefits and when the obligation can be measured reliably. Contingent liabilities and contingent assets are not recognised.

Exceptions and exemptions on transition

None.

Share-based payment transactions

Identify accounting policy choices

There is no accounting policy choice; share-based payment transactions are generally recognised at fair value over the period to vesting.

Exceptions and exemptions on transition

If FRS 20 *Share-based Payment* (or the international equivalent, IFRS 2) was applied under the previous GAAP, either that standard or Section 26 of FRS 102 must be applied at the date of transition.

In other cases, section 26 of FRS 102 need not be applied to equity instruments that were granted before the transition date or liabilities that were settled before the transition date. FRS 102.35.10 (b)

Compound financial instruments

Accounting treatment

FRS 102 requires the issuer of compound instruments to split the instrument into a liability and equity component at the date of issue. FRS 102.22.13

Exceptions and exemptions on transition

The split into a liability and equity component is not required when the liability component is not outstanding at the transition date. FRS 102.35.10(g)

Appendix 1

Illustrative examples of reconciliations

FRS 102 requirements

FRS 102.35.13

FRS 102 requires a reconciliation of an entity's equity determined in accordance with the previous GAAP to its equity determined in accordance with FRS 102 at the date of transition and at the end of the latest annual period presented under the previous GAAP. A reconciliation of profit or loss under the previous GAAP to FRS 102 is also required.

The examples below are for illustrative purposes.

Illustrative examples – option 1

Reconciliation of equity

		At 1 Jan 2014			At 31 Dec 2014		
	Note	Previous GAAP	Effect of transition	FRS 102	Previous GAAP	Effect of transition	FRS 102
		£'000	£'000	£'000	£'000	£'000	£'000
Fixed assets		14,083	-	14,083	12,998	-	12,998
Current assets	(i) (ii)	5,940	36	5,976	6,048	41	6,089
Creditors: amounts falling due within one year	(i) (iii)	(5,652)	(38)	(5,690)	(4,378)	(48)	(4,426)
Net current assets		288	(2)	286	1,670	(7)	1,663
Total assets less current liabilities		14,371	(2)	14,369	14,668	(7)	14,661
Creditors: amounts falling due after more than one year	(i)	(6,960)	(15)	(6,975)	(6,816)	(7)	(6,823)
Provisions for liabilities		(984)	-	(984)	(1,116)	-	(1,116)
Net assets		6,427	(17)	6,410	6,736	(14)	6,722
Capital and reserves		6,427	(17)	6,410	6,736	(14)	6,722

Reconciliation of profit or loss for the year

		Year ended 31 Dec 2014		
	Note	Previous GAAP	Effect of transition	FRS 102
		£'000	£'000	£'000
Turnover		1,997	-	1,997
Cost of sales	(i) (ii)	(1,248)	(7)	(1,255)
Gross profit		749	(7)	742
Administrative expenses	(i) (ii) (iii)	(156)	10	(146)
Other operating income		101	-	101
Operating profit		694	3	697
Interest receivable and similar income		12	-	12
Interest payable and similar charges		(312)	-	(312)
Taxation		(84)	-	(84)
Profit on ordinary activities after taxation and for the financial year		310	3	313

Illustrative examples – option 2

Reconciliation of equity

	Note	At 1 Jan 2014	At 31 Dec 2014
		£'000	£'000
Capital and reserves (as previously stated)		6,427	6,736
Recognition of derivative financial instruments	(i)	(5)	2
Re-measurement of stock using spot exchange rate	(ii)	-	(2)
Short-term compensated absences	(iii)	(12)	(14)
Capital and reserves (as restated)		6,410	6,722

Reconciliation of profit or loss for the year

	Note	Year ended 31 Dec 2014
		£'000
Profit for the year (as previously stated)		310
Recognition of derivative financial instruments	(i)	7
Re-measurement of stock using spot exchange rate	(ii)	(2)
Short-term compensated absences	(iii)	(2)
Profit for the year (as restated)		313

Notes to the reconciliations

The following notes are applicable to both options set out above.

Financial instruments

(i) Brit Ltd was not within the scope of FRS 26 *Financial Instruments: Recognition and Measurement* and had not previously applied it voluntarily. As a result Brit Ltd was not previously required to recognise derivative financial instruments on the balance sheet. Instead the effects of the derivative financial instruments were recognised in profit or loss when the instruments were settled. Derivative financial instruments are classified as 'other financial instruments' in FRS 102 and are recognised as a financial asset or a financial liability, at fair value, when an entity becomes party to the contractual provisions of the instrument. Consequently financial assets of £36,000 and financial liabilities of £41,000 have been recognised in the opening balance sheet at 1 January 2014. Financial assets of £43,000 and financial liabilities of £41,000 have been recognised in the balance sheet as at 31 December 2014. Derivatives are measured at fair value with gains (losses) from changes in fair value recognised in profit or loss. The effect on profit for the year ended 31 December 2014 is an increase of £7,000.

(ii) The derivative financial instruments are foreign exchange forward contracts. In applying SSAP 20 *Foreign currency translation*, Brit Ltd previously chose to translate purchases in foreign currencies at the rate of exchange specified in a matching forward contract. This is not permitted by FRS 102, which requires purchases to be translated using the spot exchange rate on the date of the transaction. FRS 102 does not provide an exemption from measuring stock bought in a foreign currency and paid for before the transition date in accordance with its required accounting policies, but the difference is not material and accordingly no adjustment has been made. Items purchased since the transition date have been re-measured based on spot exchange rate. Consequently stock at 31 December 2014 has been reduced and cost of sales for the year then ended has been increased by £2,000 and costs of £5,000 have been reclassified as administrative expenses rather than cost of sales.

Short-term compensated absences

(iii) Prior to applying FRS 102, Brit Ltd did not make provision for holiday pay (ie, holiday earned but not taken prior to the year-end). FRS 102 requires the cost of short-term compensated absences to be recognised when employees render the service that increases their entitlement. Consequently an additional accrual of £12,000 at 1 January 2014 has been made to reflect this. The additional provision at 31 December 2014 is £14,000 and the effect on profit for the year ended 31 December 2014 is an additional expense of £2,000.

PRACTICAL HELP IN A COMPLEX WORLD

Contacts and further help

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This factsheet is part of a series designed to provide practical help for Financial Reporting Faculty members in exercising their professional judgement.

The faculty cannot offer interpretations of standards or give views on the application of standards to particular companies or transactions.

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- The New UK Regime
- The New Financial Reporting Standard
- FRS 102: Financial Instruments

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Contact us

Our postal address is:
The Financial Reporting Faculty
Chartered Accountants' Hall
Moorgate Place
London EC2R 6EA

T +44 (0)20 7920 8533

E frfac@icaew.com

icaew.com/frf

Follow us on twitter: @ICAEW_FRF

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TECPLN12727