

# IFRS/UK differences – Paper P2

## For Exams in September 2017, December 2017, March 2018 and June 2018

### Introduction

This supplement provides the additional material examinable in the UK and Irish Paper. It comprises the **main areas of difference between the IFRS for SMEs and the UK FRS 102**. It is to be used in conjunction with the 2017 Study Text for examinations in September and December 2017 and March and June 2018.

**FRS 102 is derived from the IFRS for SMEs.** It is one of the new financial reporting standards replacing old UK GAAP. It can be used by UK unlisted groups and by listed and unlisted individual entities.

### Focus of supplement

The UK supplement addresses item 11 of the P2 UK Study Guide, reproduced below. Items 11(a) and 11(b) are identical in the P2 International Study Guide and are covered in the Study Text for that paper. Item 11(c) (shown in bold) is an additional requirement for the UK Paper, requiring a discussion of **key differences** in the relevant documents.

#### ACCA P2 UK Study Guide (extract)

##### 11. Reporting requirements of small and medium-sized entities (SMEs)

- (a) Discuss the accounting treatments not allowable under the *IFRS for SMEs*.
- (b) Discuss and apply the simplifications introduced by the *IFRS for SMEs* including accounting for goodwill and intangible assets, financial instruments, defined benefit schemes, exchange differences and associates and joint ventures.
- (c) **Discuss the key differences between the IFRS for SMEs and UK GAAP.**

### Examinable differences

ACCA's Examinable Documents for 2017/2018 contains the following main areas of difference between the IFRS for SMEs and UK FRS 102 and indicates whether they are examinable in P2.

IFRS for SMEs section	UK GAAP difference	Difference examinable in P2
1 Scope	FRST 100 <i>Application of Financial Reporting Requirements</i> sets out the scope of FRS 102 and establishes which accounting frameworks should be used by different entities under the UK regulatory framework.	Yes
2 Concepts and Pervasive Principles	No significant differences	No
3 Financial Statement Presentation	Companies Act requirements in relation to the true and fair override	Yes
4 Statement of Financial Position	Replaced by Companies Act requirements	No

IFRS for SMEs section	UK GAAP difference	Difference examinable in P2
5 Statement of Financial Position	Replaced by Companies Act requirements	No
6 Statement of Changes in Equity and Statement of Income and Retained Earnings	Minor differences in disclosure detail	No
7 Statement of Cash Flows	Scope amended to exclude small entities, mutual life assurance companies, pension funds and certain investment funds.	Yes
8 Notes to the Financial Statements	No significant differences	No
9 Consolidated and Separate Financial Statements	The requirements to present consolidated financial statements are amended to comply with the Companies Act.	Yes
10 Accounting Policies, Estimates and Errors	No significant differences	No
11 Basic Financial Instruments	Minor differences and clarifications	No
12 Other Financial Instruments	Minor differences and clarifications	No
13 Inventories	Clarification on inventory acquired through non-exchange transactions	Yes
14 Investments in associates	Amended scope. Equity accounting for investments in associates in individual financial statements is not permitted as it is not compliant with company law. Transaction cost are included in transaction price on initial recognition.	Yes
15 Investments in joint ventures	Amended scope. Equity accounting for interests in jointly controlled entities in individual financial statements is not permitted as it is not compliant with company law. Transactions costs are included in transaction price on initial recognition.	Yes
16 Investment Property	No significant differences	No
17 Property, Plant and Equipment	No significant differences	No

IFRS for SMEs section	UK GAAP difference	Difference examinable in P2
18 Intangible assets other than goodwill	Intangible assets that result from expenditure on internal development of intangible items may be recognised subject to certain criteria.  The cost model or revaluation model may be used after initial recognition.	Yes
19 Business Combinations and Goodwill	Treatment of bargain purchases (negative goodwill) complies with Companies Act.	Yes
20 Leases	Minor clarifications only	No
21 Provisions and Contingencies	Financial guarantee contracts included.	No
22 Liabilities and Equity	Minor clarifications only	No
23 Revenue	No significant differences	No
24 Government Grants	Additional model of accounting grants permitted (the accrual model).	Yes
25 Borrowing Costs	Amended to allow capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.	Yes
26 Share-based payment	Minor clarification only	No
27 Impairment of assets	No significant differences	No
28 Employee Benefits	Presentation of cost of defined benefit plans and the accounting for group plans amended in line with IAS 19 <i>Employee Benefits (2011)</i>	No
	Option to use a simplified valuation method in measuring the liability removed from FRS 102.	Yes
29 Income tax	Most of the section replaced	Yes
30 Foreign Currency Translation	No significant differences	No
31 Hyperinflation	No significant differences	No
32 Events after the end of the Reporting Period	Further guidance on impact of changes in the entity's going concern status	No
33 Related Party Disclosures	Disclosure exemption for wholly-owned entities available in the Companies Act added.	Yes

IFRS for SMEs section	UK GAAP difference	Difference examinable in P2
34 Specialised Activities	Additional Specialised activities are covered: Financial Institution Retirement Benefit Plans Heritage Assets Funding Commitments Incoming Resources from non-exchange Transactions Public Benefit Entity Combinations Public Benefit Entity Concessionary Loans	No

Additionally for the P2 UK paper, the changes to UK GAAP in 2015 are examinable, including an overview of FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* and the following basic Companies Act requirements surrounding when:

- Single and group entity financial statements are required and when exemptions may be claimed from the preparation.
- Subsidiary may be excluded from the group financial statements are also examinable.

# Chapter 1 Financial reporting framework

## UK GAAP

A new financial reporting framework came into effect on 1 January 2015 in the UK and Ireland. The UK's Financial Reporting Council (FRC) published four standards, forming the basis of the new regime.

- **FRS 100** *Application of Financial Reporting Requirements* which sets out the overall reporting framework
- **FRS 101** *Reduced Disclosure Framework* which permits disclosure exemptions from the requirements of EU-adopted IFRSs for certain qualifying entities
- **FRS 102** *The Financial Reporting Standard applicable in the UK and Republic of Ireland* which ultimately replaces all existing FRSs, SSAPs and UITF Abstracts
- **FRS 103** *Insurance Contracts* which consolidates existing financial reporting requirements for insurance contracts

In 2015, these were followed by **FRS 104** *Interim Financial Reporting*. This is intended for use in the preparation of interim financial reports for entities that apply FRS 102 but may also be used as a basis for preparing interim reports by those entities applying FRS 101 *Reduced Disclosure Framework*. The Standard is based on IAS 34 *Interim Financial Reporting*, with certain adaptations. It replaces the existing Accounting Standards Board (ASB) Statement *Half-yearly Financial Reports*.

## 2015 changes

In 2015, the UK Financial Reporting Council issued **amended versions of FRS 100, FRS 101 and FRS 102**. At the same time it issued **FRS 105** *The Financial Reporting Standard applicable to the Micro-entities Regime*. The changes have largely been made in response to the implementation of the new EU Accounting Directive, which was incorporated into UK Company Law in 2015, but it also incorporates other clarifications and simplifications.

The *Financial Reporting Standard for Smaller Entities* (FRSSE) was withdrawn in January 2016. Entities currently applying the FRSSE will need to apply one of the regimes set out below, in the section on FRS 100.

## This supplement

The **main standard** dealt with in this supplement and examinable at P2 is **FRS 102**.

**FRS 100 is also examinable** as it sets out the scope of FRS 102, and clarifies which accounting frameworks should be used by different entities.

The 2017/2018 Study Guide for P2 (UK) also requires knowledge of '**the July 2015 changes to UK GAAP, including an overview of FRS 105**'.

## FRS 100

### Purpose and overview

FRS 100 *Application of Financial Reporting Requirements* was issued in 2012 and is effective from 1 January 2015. It **does not contain accounting requirements** in itself but **rather provides direction** as to the relevant standard(s) for an entity (whether EU-adopted IFRSs, FRS 101, FRS 102 or FRS 105).

As a result of the implementation of the EU Accounting Directive, the introduction of FRS 105 *The Financial Reporting Standard for the Micro-entities Regime* and the withdrawal of the FRSSE, FRS 100 was revised in 2015. The six options now available for preparing financial statements are summarised below.

Type	FRS 105	FRS 102 Section 1A	FRS 102 (and FRS 103)	FRS 101	EU-adopted IFRS
Entities eligible for micro entities regime	✓	✓	✓	✓	✓
Entities eligible for small companies regime		✓	✓	✓	✓
Entities not micro or small and not required to apply EU-adopted IFRS			✓	✓	✓
Entities required to apply EU-adopted IFRS					✓

### FRS 101 Reduced disclosure Framework

FRS 101 *Reduced Disclosure Framework – Disclosure exemptions from EU-adopted IFRS for qualifying entities*, was published alongside FRS 100. It applies to the individual accounts of qualifying entities, being entities which are included in publicly available consolidated accounts. The recognition, measurement and disclosure requirements of EU-adopted IFRS are applied, but with a reduction in the required level of disclosure.

Following a 2014 amendment to FRS 101 accounts prepared in accordance with FRS 101 are **not accounts prepared in accordance with EU-adopted IFRS**.

FRS 101 was **amended in 2015**. The most important changes are:

- An exemption from the requirement of IFRS 1 to present an opening statement of financial position for qualifying entities adopting FRS 101 for the first time.
- An exemption from the requirement of IAS 24 to disclose amounts incurred by an entity for the provision of key management personnel services that are provided by a separate management entity.
- Removal of the requirement that changes in the estimated amount of contingent consideration in a business combination should be treated as an adjustment to the cost of the combination, rather than as gains or losses recognised in the profit and loss account.

FRS 101 was further amended in July 2016 to allow certain disclosure exemptions in relation to IFRS 15 *Revenue from contracts with customers* and clarify a legal requirement relating to the order in which the notes to the financial statements are presented.

### FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland

FRS 102 introduces a single standard based on the IFRS for SMEs, replacing almost all extant FRSs, SSAPs and UITF abstracts. Where an entity applies FRS 102 and also has insurance contracts, FRS 103 is also applicable.

FRS 102 was **amended in 2015**. The main changes were:

- A **new Section 1A Small Entities** is included. This sets out the presentation and disclosure requirements for a small entity that chooses to apply the small entities regime. However, these entities must still apply the recognition and measurement requirements set out in the existing sections of FRS 102.
- Qualifying entities may take advantage of **certain disclosure exemptions** from the standard.
- Where (rarely) an estimate of the useful economic life of goodwill and intangible assets cannot be made, the maximum useful life allowed is increased from five to ten years. (See Chapter 3 of this Supplement.)

- (d) Minimum requirements are set out for entities wishing to take advantage of the flexibility to adapt statutory balance sheet and profit and loss formats set out in the new Accounting Regulations.
- (e) Where the entity has the choice of settling share-based payments in cash or shares, the default accounting treatment has been reversed. Previously they were treated by default as cash-settled, whereas now they will normally be accounted for as equity-settled.
- (f) Reversal of any impairment of goodwill (see Chapter 3 of this Supplement) is now prohibited.

## **FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime**

FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* is a new accounting standard applicable to the smallest entities. It was published in July 2015 and is effective for accounting periods beginning on or after 1 January 2016.

The **2016/2017 Study Guide** for P2 UK states that you will need ‘**an overview**’ of **FRS105**.

### **Key features**

- A single accounting standard for use by companies qualifying as micro-entities and choosing to apply the micro-entities regime.
- Based on FRS 102 with significant simplifications to reflect the nature and size of micro-entities.
- Comprises 28 sections, each dealing with a specific area of accounting.
- Micro-entities must prepare a balance sheet and profit and loss account.
- Other primary statements are not required.
- Only limited disclosures needed.
- Accounts prepared in accordance with the regulations are presumed by law to give a true and fair view.
- No deferred tax or equity-settled share-based payment amounts are recognised.
- Accounting choices set out in FRS 102 are removed. No capitalisation of borrowing costs or development costs.
- All assets are measured based on historical cost, with no fair value measurement normally allowed

### **Size criteria**

A company meets the qualifying conditions for a micro-entity if it meets at least two out of three of the following thresholds:

Turnover:	Not more than £632,000
Balance sheet total:	Not more than £316,000
Average number of employees:	Not more than 10

The turnover limit is adjusted proportionately if the financial year is longer or shorter than twelve months. The rules for qualifying in the first and subsequent financial year are the same as those under the small companies regime.

A company must meet at least two of these limits in two consecutive years to qualify as a micro-entity and, once qualified, must exceed at least two of these limits for two consecutive years to cease to qualify.

### **Considerations other than size**

A number of entities are specifically excluded from the micro-entities regime:

- Charities
- Limited liability partnerships and Qualifying Partnerships
- Investment undertakings
- Financial holding and insurance undertakings
- Credit institutions
- Overseas companies
- Unregistered companies

A **subsidiary** included in consolidated group accounts by the method of **full** (as opposed to proportional) **consolidation cannot qualify** as a micro-entity.

A **parent company can** only qualify as a micro-entity for the purposes of its individual accounts **if it qualifies as a micro-entity individually and the group headed by it qualifies as small**. Also, a parent company that prepares group accounts cannot qualify as a micro- entity for the purposes of its individual accounts.

### Contents

FRS 105 consists of 28 sections, each addressing a specific area of accounting. It also includes transitional provisions and application to specialised entities.

The sections are as follows.

- 1 Scope
- 2 Concepts and Pervasive Principles
- 3 Financial Statement Presentation
- 4 Statement of Financial Position
- 5 Income Statement
- 6 Notes to the Financial Statements
- 7 Subsidiaries, Associates, Jointly Controlled Entities and Intermediate Payment Arrangements
- 8 Accounting Policies, Estimates and Errors
- 9 Financial Instruments
- 10 Inventories
- 11 Investments in Joint Ventures
- 12 Property, Plant and Equipment and Investment Property
- 13 Intangible Assets other than Goodwill
- 14 Business Combinations and Goodwill
- 15 Leases
- 16 Provisions and Contingencies
- 17 Liabilities and Equity
- 18 Revenue
- 19 Government Grants
- 20 Borrowing Costs
- 21 Share-based Payment
- 22 Impairment of Assets
- 23 Employee Benefits
- 24 Income Tax
- 25 Foreign Currency Translation
- 26 Events after the End of the Reporting Period
- 27 Specialised Activities
- 28 Transition to this FRS

### Statements of recommended practice (SORPS)

If an entity's financial statements are prepared in accordance with FRS 102 or FRS 105, SORPs will apply in the circumstances set out in those standards.

### Statement of compliance

Where an entity prepares its financial statements in accordance with FRS 101, FRS 102 or FRS 105, a statement of compliance needs to be included in the notes.

### Interpretation of equivalence

FRS 101 and FRS 102 permit certain exemptions from disclosures subject to **equivalent** disclosures being included in the consolidated financial statements of the group to which an entity belongs.

The Companies Act exempts, certain to subject conditions, an intermediate from the requirement to prepare consolidated financial statements where its parent is not established under the law of an EEA state. One of the conditions is that the group accounts are drawn up in a manner **equivalent** to consolidated accounts so drawn up.

The Application Guidance to FRS 100 provides guidance on interpreting the meaning of equivalence in both of these cases.

## Scope of FRS 102 vs scope of IFRS for SMEs

The IFRS for SMEs applies to small and medium sized entities that do not have public accountability and publish general purpose financial statements. In contrast, the scope of FRS 102 is as set out above. FRS 102:

'... is a single financial reporting standard that applies to the financial statements of entities that are not applying EU-adopted IFRS, FRS 101 or [FRS 105] ... [It] aims to provide entities with succinct financial reporting requirements. The requirements in the FRS are based on the IASB's IFRS for SMEs issued in 2009. The IFRS for SMEs is intended to apply to the general purpose financial statements of, and other financial reporting by, entities that in many countries are referred to by a variety of terms including 'small and medium-sized', 'private' and 'non-publicly accountable'.

'The IFRS for SMEs is a simplification of the principles in IFRS for recognising and measuring assets, liabilities, income and expenses; in most cases it includes only the simpler accounting treatment where IFRS permits accounting options, it contains fewer disclosures and is drafted more succinctly than IFRS. Whilst respondents to FRED 44 welcomed simplification, many did not support the removal of accounting options where those options were permitted in extant FRS. As a consequence, the ASB amended the IFRS for SMEs to include accounting options in current FRS and permitted by IFRS, but not included in the IFRS for SMEs'.

### FRS 102 Summary

Listed UK groups are required to prepare their consolidated financial statements in accordance with IFRS. FRS 102 may be applied by any other entity or group, including parent and subsidiary companies within a listed group. A company applying FRS 102 is reporting under the **Companies Act**. FRS 102 can also be used by entities that are not companies and therefore not subject to company law.

Qualifying entities may take advantage of certain disclosure exemptions within the standard. A qualifying entity for this purpose is a member of a group where the parent of that group prepares publicly available consolidated financial statements intended to give a true and fair view of the position and performance of the group and that member is included in the consolidation.

The key exemptions (not to be confused with the exemptions available under FRS 101) are:

- Preparation of a statement of cash flows
- Certain financial instrument disclosures
- Certain share-based payment disclosures
- Disclosure of key management personnel compensation
- Reconciliation of shares outstanding in the period

Entities that are required to disclose earnings per share or segment information in their financial statements should also apply IAS 33 *Earnings per Share* and/or IFRS 8 *Operating Segments*.

FRS 102 is effective for accounting periods beginning on or after 1 January 2015. It is also applicable to public benefit entities.

FRS 102 was amended in 2014, but the amendments relate to differences regarding financial instruments, which are not examinable. FRS 102 was further amended in 2015 (see above).

## Statutory 'true and fair override'

The Companies Act 2006 (CA 2006) requires that where compliance with its accounting rules would not lead to a true and fair view, **those rules should be departed from** to the extent necessary to give a true and fair view.

Where the override of the statutory accounting requirements is invoked, eg to comply with an accounting standard, **the Act requires disclosure** of the particulars of the departure, the reason for it, and the financial effect.

The CA 2006 also states that where compliance with its disclosure requirements is insufficient to give a true and fair view, **additional information should be disclosed** such that a true and fair view is provided.

This statutory true and fair override replaces paragraph 3.7 of the *IFRS for SMEs*, which deals with 'the extremely rare circumstances when management concludes that compliance with a requirement in this IFRS would be so misleading that it would conflict with the objective of financial statements of SMEs set out in Section 2 of the IFRS'.

**There are no examinable differences relating to topics in Chapter 2.**

## Chapter 3 Non-current assets

The requirements of FRS 102 in respect of non-current assets are to a large degree **the same as under IFRS**. However, entities can choose whether or not to capitalise borrowing costs.

### Property, plant and equipment: measurement after initial recognition

Following an amendment to the *IFRS for SMEs* in July 2015, there **are no longer any examinable differences from FRS 102 in respect of measurement after initial recognition**. Under **both IFRS for SMEs and FRS 102**, entities must measure all items of property, plant and equipment after initial recognition using the **cost model or the revaluation model**. Where the revaluation model is selected, this **must be applied to all items of property, plant and equipment**.

**This is, therefore, no longer an examinable difference between the IFRS for SMEs and FRS 102.**

### Borrowing costs

Under the *IFRS for SMEs* an entity recognises all borrowing costs as an **expense** in profit or loss in the period in which they are incurred.

#### FRS 102 difference

An entity **may** (it has a choice) **adopt a policy of capitalising** borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Where an entity adopts a policy of capitalisation of borrowing costs, it should be applied consistently to a class of qualifying assets.

The amount eligible for capitalisation is the actual borrowing costs incurred less any investment income on the temporary investment of those borrowings.

Where an entity **does not** adopt a policy of capitalising borrowing costs, all borrowing costs are recognised as an **expense in profit or loss** in the period in which they are incurred.

An entity should:

- (a) Capitalise borrowing costs as part of the cost of a qualifying asset from the point when it first incurs both expenditure on the asset and borrowing costs, and undertakes activities necessary to prepare the asset for its intended use or sale,
- (b) Suspend capitalisation during extended periods where active development of the asset has paused, and
- (c) Cease capitalisation when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

### Intangible assets other than goodwill: measurement after initial recognition

Under the *IFRS for SMEs* an entity must measure intangible assets after initial recognition **at cost** less any accumulated amortisation and any accumulated impairment losses.

#### FRS 102 difference

An entity must measure intangible assets after initial recognition using the **cost model** (in accordance with paragraph 18.18A) **or the revaluation model** (in accordance with paragraphs 18.18B to 18.18H). Where the revaluation model is selected, this must be applied to all items of property, plant and equipment. Where the revaluation model is selected, this **must be applied to all intangible assets in the same class**. If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset must be carried at its cost less any accumulated amortisation and impairment losses.

## Internally generated intangible assets other than goodwill: recognition

Under the *IFRS for SMEs* an entity must recognise expenditure incurred internally on an intangible item, including all expenditure for both research and development activities, as an **expense** when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in the IFRS.

### FRS 102 difference

**Internally generated** intangible assets **may** be recognised if they constitute **development costs**.

An entity may recognise an intangible asset arising from development (or from the development phase of an internal project) if, and only if, an entity can demonstrate all of the following.

- (a) The technical feasibility of completing the intangible asset so that it will be available for use or sale
- (b) Its intention to complete the intangible asset and use or sell it
- (c) Its ability to use or sell the intangible asset
- (d) How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
- (e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset
- (f) Its ability to measure reliably the expenditure attributable to the intangible asset during its development

Note that this allows the option to write off development costs which are eligible for capitalisation.

## General points on revaluation

The initial application of a policy to revalue assets in accordance with Section 17 *Property, Plant and Equipment* or Section 18 *Intangible Assets other than Goodwill* is a change in accounting policy to be dealt with as a revaluation in accordance with those sections, rather than in accordance with paragraphs 10.11 and 10.12 of Section 10 *Accounting Policies, Estimates and Errors*. (See Chapter 10 of this supplement.)

## Impairment of assets: reversal of impairment no longer allowed under either standard

Following a 2015 amendment to FRS 102, **an impairment loss recognised for goodwill must not be reversed** in a subsequent period. This is also true under the *IFRS for SMEs* (and under IAS 36).

**This is therefore no longer an examinable difference, and is mentioned here merely to illustrate the 2015 changes, which are examinable.**

## Business combinations and goodwill: useful life ten years under both standards

### IFRS for SMEs

Under the *IFRS for SMEs*, if an entity is unable to make a reliable estimate of the useful life of goodwill, the life should be presumed to be **ten years**.

### FRS 102

If an entity is unable to make a reliable estimate of the useful life of goodwill, the life should not exceed **ten years** (formerly five but amended in 2015).

This is therefore no longer an examinable difference, and is mentioned here merely to illustrate the 2015 changes, which are examinable.

## Business combinations and goodwill: negative goodwill

### FRS 102 differences

The requirements in the *IFRS for SMEs* relating to a bargain purchase (negative goodwill) have been amended to comply with the Companies Act 2006.

If **negative goodwill** arises, FRS 102, paragraph 19.24 requires that the entity:

- (a) Reassess the identification and measurement of the acquiree's assets, liabilities and provisions for contingent liabilities and the measurement of the cost of the combination. (This is in the *IFRS for SMEs*.)
- (b) Recognise and separately disclose the resulting excess on the **face of the statement of financial position** on the acquisition date, immediately below goodwill, and followed by a subtotal of the net amount of goodwill and the excess.
- (c) Recognise subsequently the excess up to the fair value of non-monetary assets acquired in profit or loss in the periods in which the non-monetary assets are recovered. Any excess exceeding the fair value of non-monetary assets acquired should be **recognised in profit or loss** in the periods expected to be benefited.

An acquirer must disclose a reconciliation of the carrying amount of the excess recognised in accordance with paragraph 19.24 at the beginning and end of the reporting period, showing separately:

- (a) Changes arising from new business combinations
- (b) Amounts recognised in profit or loss in accordance with paragraph 19.24(c)
- (c) Disposals of previously acquired businesses
- (d) Other changes

This reconciliation need not be presented for prior periods.

## Government grants

Under both the *IFRS for SMEs* and FRS 102 government grants, including non-monetary grants, must not be recognised until there is reasonable assurance that:

- (a) The entity will comply with the conditions attaching to them.
- (b) The grants will be received.

### FRS 102 difference

Under FRS 102, grants should be recognised based on **either the performance model or the accrual model**. This policy choice should be applied on a class-by-class basis.

The *IFRS for SMEs* allows only the performance model.

#### *Performance model*

Under the performance model grants are recognised as follows.

- (a) A grant that does not impose specified future performance-related conditions on the recipient is recognised in income when the grant proceeds are received or receivable.
- (b) A grant that imposes specified future performance-related conditions on the recipient is recognised in income only when the performance-related conditions are met.
- (c) Grants received before the revenue recognition criteria are satisfied are recognised as a liability.

#### *Accrual model*

Under the accrual model grants are classified as either a grant relating to revenue or a grant relating to assets.

Grants relating to revenue are recognised in income on a systematic basis over the periods in which the entity recognises the related costs for which the grant is intended to compensate.

A grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs is recognised in income in the period in which it becomes receivable.

Grants relating to assets are recognised in income on a systematic basis over the expected useful life of the asset.

Where part of a grant relating to an asset is deferred it is recognised as deferred income and not deducted from the carrying amount of the asset.

## Chapter 4 Employee benefits

Under both the *IFRS for SMEs* and FRS 102, **entities must use the projected unit credit method** to measure its defined benefit obligation and the related expense. If defined benefits are based on future salaries, the projected unit credit method requires an entity to measure its defined benefit obligations on a basis that reflects estimated future salary increases. Additionally, the method requires an entity to make various actuarial assumptions in measuring the defined benefit obligation, including discount rates, employee turnover, mortality and (for defined benefit medical plans) medical cost trend rates.

### FRS 102 difference

The *IFRS for SMEs* allows an entity to use a simplified valuation method in measuring the liability in cases where the entity cannot use the projected unit credit method without undue cost or effort. Under the simplified method, the entity can:

- (a) Ignore estimated future salary increases
- (b) Ignore future service of current employees
- (c) Ignore possible in-service mortality of current employees between the reporting date and the date employees are expected to begin receiving post-employment benefits

**This simplified valuation method is not permitted by FRS 102** and the relevant paragraph has been deleted.

**There are no examinable differences relating to topics in Chapter 5.**

# Chapter 6 Income taxes

## Main point

Section 29 of the *IFRS for SMEs* on income tax has been **replaced in its entirety** by Section 29 of FRS 102. (Note that, following the 2015 revision of the *IFRS for SMEs*, the treatment of deferred tax under that standard was brought more into line with IAS 12.)

## Current tax

A current tax liability is recognised for tax payable on taxable profit for the current and past periods. If the amount of tax paid for the current and past periods exceeds the amount of tax payable for those periods, the excess is recognised as a current tax asset.

A current tax asset is recognised for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.

A current tax liability/asset is measured at the amounts of tax the entity expects to pay/recover using the tax rates and laws that have been enacted or substantively enacted by the reporting date.

FRS 102 requires disclosure of the tax expense relating to discontinued operations.

Current tax assets and liabilities and deferred tax assets and liabilities are each offset if, and only if, there is a legally enforceable right of set-off and intention to settle on a net basis or simultaneously.

## Deferred tax

Section 29 of FRS 102 recognises deferred tax on the basis of **timing differences**, not temporary differences, as do the *IFRS for SMEs* (and IAS 12). However, the FRS 102 approach, while similar to the old UK FRS 19, is not identical. It is known as the 'timing differences plus' approach, and has a small number of differences in detail.

Timing differences are differences between taxable profit and accounting profit that originate in one period and reverse in one or more subsequent periods. Timing differences arise because certain items are included in the accounts of a period which is different from that in which they are dealt with for taxation purposes.

**Timing differences.** Differences between taxable profits and total comprehensive income as stated in the financial statements that arise from the inclusion of income and expenses.

**Under FRS 102** deferred taxation is the tax attributable to timing differences.

**Deferred tax should be recognised in respect of all timing differences at the reporting date**, subject to certain exceptions and for differences arising in a business combination.

Deferred taxation under FRS 102 is therefore a means of ironing out the tax inequalities arising from timing differences.

- (a) In years when **corporation tax is saved** by timing differences such as accelerated capital allowances, a charge for deferred taxation is made in the P&L account and a provision set up in the balance sheet.
- (b) In years when **timing differences reverse**, because the depreciation charge exceeds the capital allowances available, a deferred tax credit is made in the P&L account and the balance sheet provision is reduced.

Under the *IFRS for SMEs* (and IAS 12) a 'balance sheet' approach is taken, based on **temporary differences**. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position.

## Discounting

**FRS 102 prohibits discounting** of deferred tax assets and liabilities. (This is a change from the old UK GAAP and is in line with the *IFRS for SMEs* and IAS 12.)

### Tax allowances and depreciation of fixed assets

Deferred tax is recognised on timing differences between tax allowances and depreciation of fixed assets. If and when all conditions for retaining the tax allowances have been met, the deferred tax is reversed.



#### Question

#### Deferred tax calculation

- (a) At 30 November 20X1 there is an excess of capital allowances over depreciation of \$90m. It is anticipated that the timing differences will reverse according to the following schedule.

	30 Nov 20X2	30 Nov 20X3	30 Nov 20X4
	\$m	\$m	\$m
Depreciation	550	550	550
Capital allowances	530	520	510
	<u>20</u>	<u>30</u>	<u>40</u>

- (b) The statement of financial position as at 30 November 20X1 includes deferred development expenditure of \$40m. This relates to a new product which has just been launched and the directors believe it has a commercial life of only two years.
- (c) Corporation tax is 30% and the company wishes to discount any deferred tax liabilities at a rate of 4%.

#### Required

Explain the deferred tax implications of the above and calculate the deferred tax provision as at 30 November 20X1 in accordance with FRS 102.

**Note.** Present Value Table (extract)

Present value of \$1 ie  $(1 + r)^{-n}$  where  $r$  = interest rate,  $n$  = number of periods until payment or receipt.

Periods (n)	4%
1	0.962
2	0.925
3	0.889
4	0.855
5	0.822

#### Answer

- (a) No discounting is allowed.
- (b) Accelerated capital allowances: full provision should be made for the excess capital allowances.
- (c) Deferred development expenditure: the amount capitalised (which will have been allowable for tax as incurred) is a timing difference. Full provision is again required.

#### Deferred tax liability:

	\$m
Accelerated capital allowances (W1)	27
Deferred development expenditure (W2)	<u>12</u>
Discounted provision for deferred tax	<u>39</u>

### Workings

#### 1 Capital allowances

Timing differences \$90m

∴ Deferred tax liability \$90m × 30% = \$27m

Years to come	Reversal of timing difference	Deferred tax liability (× 30%)
	\$m	\$m
02	20	6
03	30	9
04	40	12
	<u>90</u>	<u>27</u>

#### 2 Deferred development expenditure

Timing difference \$40m

∴ Liability \$40m × 30% = \$12m

Years to come	Reversal of timing difference	Deferred tax liability (× 30%)
	\$m	\$m
02	20	6
03	20	6
	<u>40</u>	<u>12</u>

#### 3 Total deferred tax liability (27 + 12) = \$39m

### Permanent differences

With the exception of differences arising in a business combination, **permanent differences do not result in the recognition of deferred tax**. These are differences due to items being disallowed for tax purposes or non-taxable, or the amount of the tax charges or allowances differing from the amount of the related income or expense.

### Deferred tax assets

Unrelieved tax losses and other deferred tax assets may be recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

### Business combinations

Deferred tax is not recognised on income and expenses from a subsidiary, associate, branch or joint venture when:

- The reporting entity is able to control the reversal of the timing difference
- It is probable that the timing difference will not reverse in the foreseeable future

An example of this would be undistributed profits held in the other entity.

Deferred tax may arise when assets and liabilities in a business combination are recognised at fair value, which may be an amount different from the value at which they are assessed for tax.

### Other points

- Withholding tax is included in the measurement of dividends paid and received; any withholding tax suffered is included in the tax charge.
- Tax is recognised in the same component of total comprehensive income, or equity, as its related transaction.
- Deferred tax liabilities are presented within provisions; deferred tax assets are presented within debtors.
- VAT and similar sales taxes are excluded from the presentation of turnover and expenses. Irrecoverable amounts are disclosed separately.

**There are no examinable differences relating to topics in Chapters 7, 8, 9 and 10.**

# Chapter 11 Related party disclosures

## Scope of Section 33

Section 33 of both FRS 102 and the *IFRS for SMEs* requires an entity to include in its financial statements the disclosures necessary to draw attention to the possibility that its financial position and profit or loss have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

### FRS 102 difference

Disclosures need not be given of transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member.

# Chapter 12 Basic Groups

## Scope of Section 9 Consolidated and separate financial statements

This section defines the circumstances in which an entity presents consolidated financial statements and the procedures for preparing those statements. It also includes guidance on separate financial statements and combined financial statements.

### FRS 102 difference

The first sentence in the scope paragraph above is amended as follows.

This section applies to all parents that present consolidated financial statements (which are referred to as group accounts in the Act) intended to give a true and fair view of the financial position and profit or loss (or income and expenditure) of their group, whether or not they report under the Act. Parents that do not report under the Act should comply with the requirements of this section, and of the Act where referred to in this section, except to the extent that these requirements are not permitted by any statutory framework under which such entities report.

## Requirement to present consolidated financial statements

Except as permitted below, a parent entity should present consolidated financial statements in which it consolidates all its investments in subsidiaries in accordance with FRS 102. A parent entity need only prepare consolidated accounts under the Act if it is a parent at the year end.

A parent is **exempt under the Companies Act** from the requirement to prepare consolidated financial statements on any one of the following grounds.

When its immediate parent is established under the law of an EEA State (Section 400 of the Act):

- (a) The parent is a wholly-owned subsidiary. Exemption is conditional on compliance with certain further conditions set out in section 400(2) of the Act.
- (b) The immediate parent holds 90% or more of the allotted shares in the entity and the remaining shareholders have approved the exemption. Exemption is conditional on compliance with certain further restrictions set out in section 400(2) of the Act.
- (b)A The immediate parent holds more than 50% (but less than 90%) of the allotted shares in the entity and notice requesting the preparation of consolidated financial statements has not been served on the entity by shareholders holding in aggregate at least 5% of the allotted shares in the entity. Exemption is conditional on compliance with certain further restrictions set out in section 400(2) of the Act.

When its immediate parent is not established under the law of an EEA State (Section 400 of the Act):

- (c) The parent is a wholly-owned subsidiary. Exemption is conditional on compliance with certain further conditions set out in section 401(2) of the Act.
- (d) The immediate parent holds 90% or more of the allotted shares in the entity and the remaining shareholders have approved the exemption. Exemption is conditional on compliance with certain conditions set out in section 401(2) of the Act.
- (d)A The immediate parent holds more than 50% (but less than 90%) of the allotted shares in the entity and notice requesting the preparation of consolidated financial statements has not been served on the entity by shareholders holding in aggregate at least 5% of the allotted shares in the entity. Exemption is conditional on compliance with certain further conditions set out in section 401(2) of the Act.

Other situations

- (e) The parent, and the group headed by it, qualify as small as set out in section 383 of the Act and the parent and the group are considered eligible for the exemption as determined by reference to sections 384 and 399(2A) of the Act.

- (f) All of the parent's subsidiaries are required to be excluded from consolidation by paragraph 9.9 (Section 402 of the Act).
- (g) For parents not reporting under the Act, if its statutory framework does not require the preparation of consolidated financial statements.

## Exclusion of a subsidiary from consolidation

A subsidiary should be excluded from consolidation where:

- (a) Severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary, or
- (b) The interest in the subsidiary is held exclusively with a view to subsequent resale; and the subsidiary has not previously been consolidated in the consolidated financial statements prepared in accordance with FRS 102. Such subsidiaries are required to be measured at fair value with changes recognised in profit or loss.

## Special purpose entities

A special purpose entity (SPE) is an entity created for a narrow objective. Both the *IFRS for SMEs* and FRS 102 set out a number of factors to take into account in determining whether a parent has control of an SPE.

- (a) The activities of the SPE are being conducted on behalf of the entity according to its specific business needs.
- (b) The entity has the ultimate decision-making powers over the activities of the SPE even if the day-to-day decisions have been delegated.
- (c) The entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE.
- (d) The entity retains the majority of the residual or ownership risks related to the SPE or its assets.

### FRS 102 difference

FRS 102 clarifies that Employee Share Ownership Plans and similar arrangements are special purpose entities.

## Uniform reporting date and reporting period

A subsidiary's financial statements used to prepare the consolidated financial statements usually have the same reporting date as the parent unless it is **impracticable** to do so.

### FRS 102 difference

If a subsidiary's reporting date is different, the consolidated financial statements must be made up:

- (a) From the financial statements of the subsidiary as of its last reporting date before the parent's reporting date, adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements, provided that reporting date is no more than three months before that of the parent, or
- (b) From interim financial statements prepared by the subsidiary as at the parent's reporting date.

## Individual financial statements

The *IFRS for SMEs* does not require presentation of separate financial statements for the parent entity or for the individual subsidiaries. However, FRS 102 clarifies the distinction between the individual and separate financial statements, and that the Companies Act specifies when individual financial statements are required to be prepared.

Separate financial statements are those prepared by a parent in which the investments in subsidiaries, associates or jointly controlled entities are accounted for either at cost or fair value rather than on the basis of the reported results and net assets of the investees. Separate financial statements are included within the meaning of individual financial statements.

## Equity accounting not allowed in individual financial statements

### Associates

Under the *IFRS for SMEs*, an entity may account for associates in its individual financial statements using:

- (a) The cost model
- (b) The equity model
- (c) The fair value model

### FRS 102 difference

The FRS gives guidance for an entity that is not a parent, but which holds investments in associates.

The **equity method** of accounting for investments in associates in **individual financial statements** is **disallowed**, as it is **not compliant with company law**. Instead, entities may account for associates in their individual financial statements using:

- (a) The cost model
- (b) Not used
- (c) The fair value method with changes recognised in other comprehensive income
- (d) At fair value with changes recognised in profit or loss

### Transaction costs

When an investment in an associate is recognised initially, an investor that is not a parent, that chooses to adopt the fair value model, must measure it at the transaction price. **Under the *IFRS for SMEs*, transaction price did not include transaction costs, but they are included under FRS 102.**

### Jointly controlled entities

Under the *IFRS for SMEs*, an entity may account for jointly controlled entities in its individual financial statements using:

- (a) The cost model
- (b) The equity model
- (c) The fair value model

### FRS 102 difference

The FRS gives guidance for a venturer that is not a parent.

### Joint ventures

The **equity method** of accounting for investments in joint ventures in **individual financial statements** is **disallowed**, as it is **not compliant with company law**. Instead, entities may account for jointly controlled entities in their individual financial statements using.

- (a) The cost model
- (b) Not used
- (c) The fair value method with changes recognised in other comprehensive income
- (d) At fair value with changes recognised in profit or loss

### Transaction costs

When an investment in a jointly controlled entity is recognised initially, an investor that is not a parent, that chooses to adopt the fair value model, must measure it at the transaction price. **Under the *IFRS for SMEs*, transaction price did not include transaction costs, but they are included under FRS 102.**

# Chapter 13 Complex groups and joint arrangements

## FRS 102 difference – additional clarification

An investor that has investments in associates or jointly controlled entities that are held as part of an investment portfolio must measure those investments at fair value with changes recognised in profit or loss in their consolidated financial statements.

## Use of equity method in individual financial statements

See Chapter 12.

# Chapter 14 Changes in group structures

## FRS 102 difference – additional clarification

FRS 102 provides additional information to the *IFRS for SMEs* regarding the treatment of changes in group structures, as follows.

### Where control is lost

When a parent ceases to control a subsidiary, any gain or loss on loss of control is recognised in profit or loss. This is calculated as the difference between the proceeds and the transaction date carrying amount of the portion of the subsidiary disposed of or lost.

Items recorded in other comprehensive income in relation to the former subsidiaries, are recycled through profit or loss if they would be recycled were the underlying assets or liabilities to which they relate disposed of directly.

### Where control is retained

Where a parent reduces its holding in a subsidiary and control is retained, it must be accounted for as a transaction between equity holders and the resulting change in non-controlling interest is compared with the fair value of the consideration, with any difference recognised in equity.

No gain or loss is recognised at the date of disposal.

### Acquisition in stages

Where control is achieved following a series of transactions, the cost of the business combination is the aggregate of the fair values of the assets given, liabilities assumed and equity instruments issued by the acquirer at the date of each transaction in the series.

**There are no examinable differences relating to topics in Chapters 15 or 16.**

## Chapter 17 Group statements of cash flows

The only additional difference that is examinable in P2 relates to the exemptions available from preparing a statement of cash flows.

**Under FRS 102, but not specified in the *IFRS for SMEs***, the following entities are **exempt** from preparing a cash flow statement.

- Small companies
- Mutual life assurance companies
- Pension schemes
- Investment funds in which substantially all of the entity's investments are highly liquid, substantially all of the entity's investments are carried at market value, and the entity provides a statement of changes in net assets

**There are no examinable differences relating to topics in Chapters 18, 19 and 20.**

## Chapter 21 Reporting for small and medium-sized entities

You have studied the *IFRS for SMEs* in your BPP Study Text and will have looked at the differences in this supplement, as they relate to the individual chapters of the Study Text.

Note that the *IFRS for SMEs* was amended in 2015, as was FRS 102. The two appear to be coming closer together.

There is one remaining examinable difference that does not fit into any of the Study Text chapters, because it relates to inventory, which is an F7 topic, though assumed knowledge.

### **Inventories acquired through a non-exchange transaction**

Where inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition. For public benefit entities and entities within a public benefit entity group, this requirement only applies to inventories that are recognised as a result of the requirements for incoming resources from non-exchange transactions as prescribed in Section 34 of the FRS, which deals with Specialised Activities.

# ACCA PAPER P2 (UK/IRL) 2017:

## Supplementary UK/Irish stream examples

*These questions test P2 Study Guide, requirement 11(d)*

(d) Discuss the key differences between the IFRS for SMEs and UK GAAP.

*'Up to' 20 marks of the P2 UK/Irish Paper could be available to test these UK/Irish differences. 'UK GAAP' now refers to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.*

*This document contains some example replacement parts or 'tag-ons' to past exam questions in the 2017 Paper P2 Practice & Revision kit, illustrating how the examiner could test the differences.*

## QUESTIONS

### 29 Klancet (ACCA Exam Question 3, June 2015)

(c) Coact, a UK entity, is collaborating with Retto Laboratories (Retto), a third party, to develop two existing drugs owned by Coact.

In the case of the first drug, Retto is simply developing the drug for Coact without taking any risks during the development phase and will have no further involvement if regulatory approval is given. Regulatory approval has been refused for this drug in the past. Coact will retain ownership of the patent rights attached to the drug. Retto is not involved in the marketing and production of the drug. Coact has agreed to make the two non-refundable payments to Retto of \$4 million on the signing of the agreement and \$6 million on successful completion of the development.

Coact and Retto have entered into a second collaboration agreement in which Coact will pay Retto for developing and manufacturing an existing drug. The existing drug already has regulatory approval. The new drug being developed by Retto for Coact will not differ substantially from the existing drug. Coact will have exclusive marketing rights to the drug if the regulatory authorities approve it. Historically, new drugs of this kind receive approval if they do not differ substantially from an existing approved drug.

The contract terms require Coact to pay an upfront payment on signing of the contract, a payment on securing final regulatory approval, and a unit payment of \$10 per unit, which equals the estimated cost plus a profit margin, once commercial production begins.

The cost-plus profit margin is consistent with Coact's other recently negotiated supply arrangements for similar drugs.

Coact would like to know how to deal with the above contracts with Retto.

*Required*

Discuss the different ways in which the above contracts would be accounted for under FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, and the *IFRS for SMEs*. **(8 marks)**

### 32 Egin group

Car Ltd acquired 100% of Trice Ltd, a company which applies FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. Trice earned 60% of its profits from transactions with Car.

Briefly explain how the related party disclosures in the financial statements of Trice would be different under UK GAAP from disclosures that would be required if Trice applied the *IFRS for Small and Medium-sized Enterprises*. **(2 marks)**

## 45 Case study question: Joey (ACCA Exam Question 1, December 2014)

- (b) The directors of Joey have heard that the Financial Reporting Council in the UK has published three Financial Reporting Standards (FRSs), which will replace UK GAAP in the UK and Republic of Ireland. They are confused as to the nature of the new standards and whether their UK operations including the holding company are affected or qualify for the use of the standards.

*Required*

Outline the key changes to UK GAAP and discuss the eligibility criteria for any UK operations of the Joey Group. (8 marks)

## 46 Case study question: Kutchen (ACCA Exam Question 1, June 2015)

- (b) Kutchen has been considering purchasing a UK group of companies. The group is a qualifying entity for the purpose of applying FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. However, the UK group has a complex structure and some of the subsidiaries are currently available for sale. As a consequence, the directors of Kutchen would like advice on the interaction of FRS 102 and the Companies Act 2006, and the requirements regarding exemptions from the preparation of group accounts and the exclusion of subsidiaries from consolidation.

*Required*

Advise the directors of Kutchen regarding the requirements to prepare group accounts and the exclusion of subsidiaries from consolidation under FRS 102 and the Companies Act 2006.

(8 marks)

## 51 Case study question: Bubble (ACCA Exam Question 1, Sep/Dec 2015)

- (b) Bubble is considering purchasing a UK subsidiary and has heard that FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* has different accounting requirements for deferred taxation than *IFRS for SMEs* and, in particular, as regards accounting for a deferred tax asset.

*Required*

Discuss the difference in the general recognition principle between FRS 102 and *IFRS for SMEs* in accounting for deferred taxation and the difference in the way in which deferred tax assets are dealt with under these two standards. (9 marks)

## \*\* Rose (no equivalent in international kit)

- (b) Rose was considering acquiring a service company. Rose decided that in valuing the net assets of the service company, the most advantageous accounting policies from FRS 102 and the *IFRS for SMEs* would be utilised. The following accounting practices were proposed to be adopted by Rose.
- (i) The deferred taxation balance was to be arrived at using a temporary differences approach.
  - (ii) A choice was to be made to capitalise borrowing costs.
  - (iii) A choice was to be made to capitalise development costs.
  - (iv) The accrual model was to be adopted for recognising government grants.

Discuss whether the above accounting practices are acceptable under FRS 102 and the *IFRS for Small and Medium Sized Entities*, and whether attempting to choose the most advantageous accounting treatment raises any ethical issues. (10 marks)

### **53 Case study question: Weston (ACCA Exam Question 1, Mar/Jun 2016)**

- (b) The directors of Weston are looking at the requirements of IFRS for SMEs and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, with regards to accounting for goodwill including the impact of a bargain purchase. The directors would like advice on this issue as the entity is preparing to purchase a UK subsidiary at a competitive price.

*Required*

Describe the key differences in accounting for goodwill under IFRS for SMEs and FRS 102.

(8 marks)

### **59 Mehran (ACCA Exam Question 2, Mar/Jun 2016)**

- (b) Mehran has a UK subsidiary which has by law to provide a pension scheme for its employees. A lump-sum benefit is payable on termination of service and is equal to 1% of final salary for each year of service. Mehran has given you details of a typical entrant to the scheme. An employee earning \$30,000 at present would be expected to earn a salary of \$39,300 at the end of five years.

Given a discount rate of 10%, Mehran would like to know what the current service cost would be in the current year for such an employee who retires after five years and wishes to know if there are any differences between accounting for pensions under IFRS for SMEs and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

*Required*

Advise Mehran on the issues raised above.

(6 marks)

### **64 Kayte (ACCA Exam Question 3, December 2014)**

- (b) Kayte owns an entity, which currently uses 'old' UK GAAP to prepare its financial statements. The directors of Kayte are unsure of the business implications of the new Financial Reporting Standards (new UK GAAP), and also how accounting for certain transactions differs from IFRS for SMEs. They are particularly concerned about the accounting for income tax.

*Required*

Prepare a report to the Directors of Kayte, setting out the business implications of a change from 'old' to 'new' UK GAAP and an explanation as to how income tax would be accounted for under 'new' UK GAAP as compared to *IFRS for SMEs*. (11 marks)

### **68 Decany (ACCA Exam Question 2, December 2011)**

As Ceed is now a parent company, the directors are unsure as to the requirements to prepare group accounts under UK GAAP/company law. All companies are incorporated in the UK.

*Required*

- (a) (ii) Set out the requirements of UK GAAP/company law as regards the requirement to produce group accounts, advising the directors as to the position of Ceed. (5 marks)

## 72 Whitebirk

### (ACCA Exam Question 4, December 2010, amended)

- (a) Outline the approach taken under UK/Irish GAAP to accounting for small and medium-sized entities, indicating how this differs from that taken by the IASB. **(5 marks)**
- (b) Whitebirk has met the definition of a SME in its jurisdiction and wishes to comply with the *IFRS for Small and Medium-sized Entities*. The entity wishes to seek advice on how it will deal with the following accounting issues in its financial statements for the year ended 30 November 20X2. The entity already prepares its financial statements under full IFRS.
- (i) Whitebirk purchased 90% of Close, a SME, on 1 December 20X1. The purchase consideration was \$5.7m and the value of Close's identifiable assets was \$6m. The value of the non-controlling interest at 1 December 20X1 was measured at \$0.7m. Whitebirk has used the full goodwill method to account for business combinations and the life of goodwill cannot be estimated with any accuracy. Whitebirk wishes to know how to account for goodwill under the *IFRS for SMEs*.
- (ii) Whitebirk has incurred \$1m of research expenditure to develop a new product in the year to 30 November 20X2. Additionally, it incurred \$500,000 of development expenditure to bring another product to a stage where it is ready to be marketed and sold.
- (iii) Whitebirk purchased some properties for \$1.7m on 1 December 20X1 and designated them as investment properties under the cost model. No depreciation was charged as a real estate agent valued the properties at \$1.9m at the year end.
- (iv) Whitebirk has an intangible asset valued at \$1m on 1 December 20X1. The asset has an indefinite useful life, and in previous years had been reviewed for impairment. As at 30 November 20X2, there are no indications that the asset is impaired.

#### *Required*

Discuss how the above transactions should be dealt with in the financial statements of Whitebirk, with reference to the IFRS for Small and Medium-sized Entities. **(10 marks)**

- (c) How would your answers for each of the four transactions differ if Whitebirk were complying instead with FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*? **(8 marks)**

Professional marks will be awarded in this question for clarity and quality of discussion. **(2 marks)**

**(Total = 25 marks)**

### \*\*\* Apple (no equivalent in International Kit)

Apple, a company originally located in a foreign country and applying the *IFRS for SMEs* has recently moved its operations to the UK. It is eligible to apply FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. Apple acquired 52% of the ordinary shares of Orange on 1 May 20X7. Orange is located in a foreign country. Orange currently operates under severe long-term restrictions that impair its ability to transfer funds to Apple. Control of Orange has not been lost by Apple.

#### *Required*

Describe the FRS 102 rules regarding the exclusion of subsidiaries from consolidation, discussing whether Orange would be excluded from consolidation under FRS 102 and the *IFRS for Small and Medium Sized Entities*.

**(7 marks)**

## 81 Case study question: Zippy (ACCA Exam Question 1, Sep/Dec 2016)

- (b) The directors of Zippy have heard that the Financial Reporting Council (FRC) has issued a suite of changes which updates and, in many cases simplifies, UK and Ireland accounting standards. They have been told that the key changes include new requirements for micro-entities and small entities and the withdrawal of the *Financial Reporting Standard for Smaller Entities (FRSSE)*. Further they understand that the changes are largely in response to the implementation of the new EU Accounting Directive and include a new standard, FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*; a new Section 1A 'Small entities' in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and other changes necessary for continued compliance with company law.

*Required*

Advise the directors of Zippy on the recent changes, which the FRC has introduced for continued compliance with UK company law. (8 marks)

## 82 Suntory (ACCA Exam Question 2, Sep/Dec 2016)

- (b) At 30 November 20X6, three people own the shares of Bobarra, a company which meets the small and medium-sized criteria. The finance director owns 60%, and the operations director owns 30%. The third owner is a passive investor who does not help manage the entity. All ordinary shares carry equal voting rights. The wife of the finance director is the sales director of Bobarra. Their son is currently undertaking an apprenticeship with Bobarra and receives a salary of \$30,000 per annum, which is normal compensation.

The finance director and sales director have set up a trust for the sole benefit of their son. The trust owns 60% of the ordinary shares of Santarem which carry voting rights. The finance director and sales director are trustees of the trust.

Finally, Bobarra owns 100% of the shares in Alucant, which in turn owns 100% of the shares in Cantor. Alucant also has a 80% holding of the shares of Drumby. There have been transactions in the year between Bobarra and Drumby.

Bobarra is comparing IFRS for SMEs and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and requires advice on the identification of its related parties for preparing its separate financial statements for the year ending 30 November 20X6.

*Required*

Advise Bobarra on how the above transactions should be correctly dealt with in its financial statements if it were to comply with IFRS for SMEs or FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. (7 marks)

## 83 Volutee (ACCA Exam Question 3, Sep/Dec 2016)

- (b) Volutee operates in a jurisdiction with a specific tax regime for unlisted companies. Upon adoption of this tax regime, the entity has to pay a single tax payment based on the unrealised gains on acquired intangible assets. Volutee purchased Monk whose only asset was a customer list valued at \$2 million. The purchase price of Monk was below the market value of the customer list which was \$2.3 million and Volutee chose to account for the investment property under the cost model. At the same time, Volutee opted for the specific tax regime for the newly acquired intangible asset and agreed to pay the corresponding tax of \$100,000. Volutee considered that the tax payment qualifies as an expenditure attributable to the acquisition of the asset. Hence, the tax payment was capitalised and the value of the intangible asset was stated at \$2.1 million.

The directors of Volutee wish to know if the above accounting treatment of the tax payment is acceptable under *IFRS for SMEs* and whether there were any significant valuation differences between accounting for acquired intangible assets under IFRS for SMEs and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

*Required*

Advise the directors of Volutee as to the accounting treatment of the tax payment and whether there are any significant valuation differences between accounting for acquired intangible assets under *IFRS for SMEs* and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

**(6 marks)**

# SOLUTIONS

## 29 Klancet (ACCA Exam Question 3, June 2015)

- (c) Under *IFRS for SMEs*, all research and development costs are recognised as an expense. No intangible assets would therefore be recognised in respect of either of these contracts during the research and development stage.

However, FRS 102 takes a different approach. In assessing whether the recognition criteria are met for an internally generated intangible asset, research and development costs are split into a research phase and a development phase. If an entity cannot distinguish between the two phases, then all expenditure on the project is treated as relating to the research phase. Expenditure relating to the research phase of a project is expensed as incurred. An entity makes an accounting policy choice to capitalise expenditure in the development phase as an intangible asset or recognise it as an expense. If it adopts a policy of capitalisation, this applies to a development if, and only if, the entity can demonstrate that a series of criteria have all been met. These are:

- (i) The project is technically feasible.
- (ii) the entity intends to complete the project and use or sell the intangible asset; the entity is able to sell or use the asset.
- (iii) It is probable that the asset will generate future economic benefits.
- (iv) The entity has sufficient resources to complete the project.
- (v) The entity can measure reliably the directly attributable expenditure.

If these criteria are met, then from that date all costs which are directly attributable to creating, producing, and preparing the asset to be capable of operating in the manner intended by management are capitalised.

FRS 102 permits an entity to recognise an intangible asset when it is probable that the entity will receive the expected future economic benefits attributable to the asset, and its cost or value can be measured reliably. This requirement applies whether an intangible asset is acquired externally or generated internally. The price which an entity pays to acquire an intangible asset reflects its expectations about the probability that the expected future economic benefits in the asset will flow to the entity. The effect of probability is reflected in the cost of the asset and the probability recognition criterion above is always considered to be satisfied for separately acquired intangible assets. The cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets. The cost of a separately acquired intangible asset comprises its purchase price and any directly attributable cost of preparing the asset for its intended use.

In the case of the first project, Coact owns the potential new drug, and Retto is carrying out the development of the drug on its behalf. The risks and rewards of ownership remain with Coact. By paying the initial fee and the subsequent payment to Retto, Coact does not acquire a separate intangible asset, which could be capitalised. The payments represent research and development by a third party, which needs to be expensed over the development period provided that the recognition criteria for internally generated intangible assets are not met. Development costs are capitalised only after technical and commercial feasibility of the asset for sale or use have been established. This means that the entity must intend and be able to complete the intangible asset and either uses it or sells it and be able to demonstrate how the asset will generate future economic benefits. At present, this criterion does not appear to have been met as regulatory authority for the use of the drug has not been given, and in fact, approval has been refused in the past.

In the case of the second project, the drug has already been discovered and therefore the costs are for the development and manufacture of the drug and its slight modification. There is no indication that the agreed prices for the various elements are not at fair value. In particular, the terms for

product supply at cost plus profit are consistent with Coact's other supply arrangements. Therefore, Coact may capitalise the upfront purchase of the drug and subsequent payments as incurred, and consider impairment at each financial reporting date. Regulatory approval has already been attained for the existing drug and therefore there is no reason to expect that this will not be given for the new drug. Amortisation should begin once regulatory approval has been obtained. Costs for the products have to be accounted for as inventory and then expensed as costs of goods sold as incurred.

## 32 Egin Group

Car owns 100% of Trice. Under FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, disclosures need not be given of transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member.

Trice Ltd does not, therefore, need to disclose transactions with Car Ltd.

This exemption is not available under the *IFRS for SMEs*.

## 45 Case study question: Joey (ACCA Exam Question 1, December 2014)

### (b) Report to the directors of Joey: changes to UK GAAP

A new financial reporting framework came into effect on 1 January 2015 in the UK and Ireland. The UK's Financial Reporting Council (FRC) published four standards which together form the basis of the new UK regime, of which the first three are relevant:

- (i) **FRS 100** *Application of Financial Reporting Requirements* which sets out the overall reporting framework.
- (ii) **FRS 101** *Reduced Disclosure Framework* which permits disclosure exemptions from the requirements of EU-adopted IFRSs for certain qualifying entities.
- (iii) **FRS 102** *The Financial Reporting Standard applicable in the UK and Republic of Ireland* which ultimately replaces all existing FRSs, SSAPs and UITF Abstracts. This will be the new IFRS for UK reporters.

The Financial Reporting Standard for Smaller Entities will continue to be available for those that qualify to use it and will remain fundamentally unaltered for the time being.

FRS 100 *Application of Financial Reporting Requirements* was issued in November 2012 and is effective from 1 January 2015. It **does not contain accounting requirements** in itself but **rather provides direction** as to the relevant standard(s) for an entity:

- (i) EU-adopted IFRS
- (ii) FRS 101 for the individual accounts of a qualifying entity
- (iii) FRS 102
- (iv) The FRSSE

All but the first of these are Companies Act accounts.

**FRS 101** *Reduced Disclosure Framework – Disclosure exemptions from EU-adopted IFRS for qualifying entities*, was published alongside FRS 100. It applies to the individual accounts of qualifying entities, being entities which are included in publicly available consolidated accounts. The recognition, measurement and disclosure requirements of EU-adopted IFRS are applied, but with a **reduction in the required level of disclosure**. However, companies should consider the advantages and disadvantages of the other options before choosing this one. FRS 101 and FRS 102 permit certain exemptions from disclosures subject to **equivalent** disclosures being included in the consolidated financial statements of the group to which an entity belongs.

**FRS 102** introduces a **single standard based on the IFRS for SMEs**, replacing almost all extant FRSs, SSAPs and UITF abstracts. Listed UK groups are required to prepare their consolidated financial statements in accordance with IFRS. FRS 102 may be applied by any other entity or group, including parent and subsidiary companies within a listed group. A company applying FRS 102 is reporting under the **Companies Act**. FRS 102 can also be used by entities that are not companies and therefore not subject to company law.

## 46 Case study question: Kutchen (ACCA Exam Question 1, June 2015)

- (b) The requirements in the Companies Act 2006 to prepare group accounts are largely mirrored in FRS 102, which states that consolidated financial statements (group accounts in the Companies Act) are prepared by all parent entities unless one of the following exemptions which are derived from the Companies Act applies:
- (i) The parent company is subject to the small companies regime (see ss 383 to 384 of the Companies Act).
  - (ii) The parent company is a subsidiary included in a larger group which prepares consolidated financial statements and meets the requirements of ss.400 or 401 of the Companies Act, including:
    - (1) The parent is itself a subsidiary whose immediate parent is established in an EEA state, and whose results are consolidated into the group financial statements of an undertaking established in an EEA state (not necessarily the immediate parent). Section 400 sets out further conditions for this exemption, including that a company which has any of its securities admitted to trading on a regulated market in an EEA state is not eligible for this exemption.
    - (2) The parent is itself a subsidiary, its immediate parent is not established in an EEA state, and its results are consolidated into the group accounts of an undertaking (either the same parent or another) drawn up in accordance with the EU Seventh Directive or in an equivalent manner (for example, EU-IFRS accounts).  
  
Section 401 sets out further conditions for this exemption, including that a company which has any of its securities admitted to trading on a regulated market in an EEA state is not eligible for this exemption.
  - (iii) All of the parent's subsidiaries are excluded from consolidation under FRS 102.  
  
If an entity is not a parent at the year end, then it is not required to prepare consolidated accounts.

### Exclusion of subsidiaries from consolidation

Consolidated financial statements provide information about the group as a single economic entity. They include all subsidiaries of the parent except those excluded on one of the following grounds:

- (i) Severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary. These rights are the rights held by or attributed to the company in the absence of which it would not be the parent company, or
- (ii) The subsidiary is held exclusively for resale and has not previously been included in the consolidation.

A subsidiary excluded from consolidation due to severe long-term restrictions is, if the parent still exercises significant influence, equity accounted and treated as an associate. Otherwise, the parent has a choice of accounting policy to measure the subsidiary either at cost less impairment, or at fair value through other comprehensive income (OCI) with movements below cost recorded in profit or loss or at fair value through profit or loss.

A subsidiary excluded from consolidation on the basis of not previously having been consolidated and being held exclusively for resale is accounted for in accordance with FRS 102, which gives a choice of accounting policy of either cost less impairment, fair value through OCI with movements below cost recorded in profit or loss or fair value through profit or loss unless it is held as part of an investment portfolio. If it is held as part of an investment portfolio, it is held at fair value through profit or loss.

Section 405 of the Companies Act states that a subsidiary may be excluded from consolidation if the necessary information to prepare the group accounts cannot be obtained without disproportionate expense or undue delay. FRS 102, however, states that this does not justify non-consolidation, effectively closing off the statutory option. Subsidiaries are not excluded from consolidation because the subsidiary has dissimilar business activities to the rest of the group.

## 51 Case study question: Bubble (ACCA Exam Question 1, Sep/Dec 2015)

- (b) The section of the *IFRS for SMEs* on income tax has been replaced in its entirety by the section in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. FRS 102 recognises deferred tax on the basis of timing differences, not temporary differences as does the *IFRS for SMEs* (and IAS 12 *Income taxes*). However, the FRS 102 approach, while similar to the previous UK GAAP, is not identical. It is known as the 'timing differences plus' approach.

Under FRS 102, deferred tax is recognised in respect of all timing differences at the reporting date, with some exceptions. Timing differences are differences between taxable profits and total comprehensive income as stated in the financial statements which arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in financial statements. Deferred tax should be recognised in respect of all timing differences at the reporting date, subject to certain exceptions.

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits. The very existence of unrelieved tax losses is strong evidence that there may not be other future taxable profits against which the losses will be relieved.

Under IFRS for SMEs, an entity recognises a deferred tax asset or liability for tax recoverable or payable in future periods as a result of past transactions or events. Such tax arises from the difference between the amounts recognised for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities plus the carry forward of currently unused tax losses and tax credits. A deferred tax asset must be recognised for all temporary differences which are expected to reduce taxable profit in the future. An entity must recognise a valuation allowance against deferred tax assets so that the net carrying amount equals the highest amount which is more likely than not to be recovered based upon current or future taxable profit. An entity must review the net carrying amount of a deferred tax asset at each reporting date and adjust the valuation allowance to reflect the current assessment of future profits. Such adjustment is recognised in profit or loss except if it is attributable to an item in other comprehensive income (OCI) in which case it is recognised in OCI.

### \*\* Rose (no equivalent in international kit)

- (b) (i) **Deferred tax**

The concept underlying accounting for deferred tax is different under FRS 102 from the concept under the *IFRS for SMEs* (and full IFRS). Rose would not be able to apply the temporary differences approach under FRS 102.

Under the *IFRS for SMEs* a 'balance sheet' approach is taken, based on **temporary differences**. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position.

By contrast, FRS 102 focuses on **timing differences**. These are differences between taxable profit and accounting profit that originate in one period and reverse in one or more subsequent periods. **Timing differences** arise because certain items are included in the accounts of a period which is different from that in which they are dealt with for taxation purposes. Under FRS 102 deferred taxation is the tax **attributable to timing differences**.

The FRS 102 approach is similar to the old UK FRS 19 but not identical. It is known as the **'timing differences plus'** approach, and has a small number of differences in detail.

(ii) **Capitalisation of borrowing costs**

The *IFRS for SMEs* requires an entity to recognise all borrowing costs as an **expense** in profit or loss in the period in which they are incurred. If Rose uses the *IFRS for SMEs* it will have no choice.

Under FRS 102, entities have a choice. They may **adopt a policy of capitalising** borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Where an entity adopts a policy of capitalisation of borrowing costs, it should be applied consistently to a class of qualifying assets.

The amount eligible for capitalisation is the actual borrowing costs incurred less any investment income on the temporary investment of those borrowings.

Where an entity **does not** adopt a policy of capitalising borrowing costs, all borrowing costs are recognised as an **expense in profit or loss** in the period in which they are incurred.

Management might therefore prefer to use FRS 102, because capitalising borrowing costs could, depending on the circumstances, give a more favourable presentation.

(iii) **Capitalisation of development costs**

The key difference between FRS 102 and the *IFRS for SMEs* is that under the *IFRS for SMEs* an entity must recognise expenditure incurred internally on an intangible item, including all expenditure for both research and development activities, as an **expense** when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in the IFRS. FRS 102, on the other hand, **allows a choice**. Development costs **may be written off, or they may be capitalised**. In order to capitalise development costs Rose would need to demonstrate the following:

- (1) The technical feasibility of completing the intangible asset so that it will be available for use or sale.
- (2) Its intention to complete the intangible asset and use or sell it.
- (3) Its ability to use or sell the intangible asset.
- (4) How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
- (5) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
- (6) Its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Management might therefore prefer to use FRS 102, because capitalising development expenditure could, depending on the circumstances, give a more favourable presentation.

(iv) Accrual method for government grants

The *IFRS for SMEs* allows only the performance model for recognising government grants. Under this model:

- (1) A grant that does not impose specified future performance-related conditions on the recipient is recognised in income when the grant proceeds are received or receivable.
- (2) A grant that imposes specified future performance-related conditions on the recipient is recognised in income only when the performance-related conditions are met.
- (3) Grants received before the revenue recognition criteria are satisfied are recognised as a liability.

FRS 102 permits a choice. Government grants should be recognised based on **either the performance model or the accrual model**. This policy choice should be applied on a class-by-class basis. Under the accrual model grants are classified as either a grant relating to revenue or a grant relating to assets.

Grants relating to revenue are recognised in income on a systematic basis over the periods in which the entity recognises the related costs for which the grant is intended to compensate.

A grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs is recognised in income in the period in which it becomes receivable.

Management might therefore prefer to use FRS 102, because under the accrual model, grants are likely to be recognised sooner, particularly if no conditions related to future performance are imposed.

**Ethical issues in attempting to choose the most advantageous accounting treatment**

**Ethical behaviour** in the preparation of financial statements, and in other areas, is of **paramount importance**. Directors act unethically if they use 'creative' accounting in accounts preparation to make the figures look better, in particular if their presentation is determined not by finding the best way to apply International Financial Reporting Standards, or indeed UK/Irish GAAP, but by personal gain, for example a profit-related bonus. **'Cherry picking'** advantageous accounting treatments from UK/Irish GAAP and IFRS falls **outside the bounds of acceptable accounting practice, particularly if the intention is to mislead users** of financial statements.

## 53 Case study question: Weston (ACCA Exam Question 1, Mar/Jun 2016)

- (b) Under the *IFRS for SMEs*, an impairment loss recognised for goodwill must not be reversed in a subsequent period whereas under FRS102, an impairment loss recognised for all assets, including goodwill, may be reversed in a subsequent period if and only if the reasons for the impairment loss have ceased to apply. Under the *IFRS for SMEs*, if an entity is unable to make a reliable estimate of the useful life of goodwill, the life should be presumed to be ten years. Under FRS 102, if an entity is unable to make a reliable estimate of the useful life of goodwill, the life should not exceed five years.

The requirements in the *IFRS for SMEs* relating to a bargain purchase have been amended in FRS 102 to comply with the Companies Act 2006.

If a bargain purchase arises, FRS 102 requires the entity to:

- (i) Reassess the identification and measurement of the acquiree's assets, liabilities and provisions for contingent liabilities and the measurement of the cost of the combination. This condition is the same in *the IFRS for SMEs*.

- (ii) Recognise and separately disclose the resulting excess on the face of the statement of financial position on the acquisition date, immediately below goodwill, and followed by a subtotal of the net amount of goodwill and the excess.
- (iii) Recognise subsequently the excess up to the fair value of non-monetary assets acquired in profit or loss in the periods in which the non-monetary assets are recovered. Any excess exceeding the fair value of non-monetary assets acquired should be recognised in profit or loss in the periods expected to benefit.

An acquirer must disclose a reconciliation of the carrying amount of the excess recognised.

## 59 Mehran (ACCA Exam Question 2, Mar/Jun 2016)

- (b) The benefit attributed to the current year would be 1% of \$39,300, ie \$393.

The current service cost for the current year is the present value of benefit attributed to the current year, ie \$393 discounted for four years at 10% per annum which is \$268.

Under both the *IFRS for SMEs* and FRS 102, entities must use the projected unit credit method to measure its defined benefit obligation and the related expense. Under *IFRS for SMEs*, if an entity is able, without undue cost or effort, to use the projected unit credit method to measure its defined benefit obligation and the related expense, it shall do so. If defined benefits are based on future salaries, the projected unit credit method requires an entity to measure its defined benefit obligations on a basis which reflects estimated future salary increases. Additionally, the projected unit credit method requires an entity to make various actuarial assumptions in measuring the defined benefit obligation, including discount rates, the expected rates of return on plan assets, expected rates of salary increases, employee turnover, mortality, and (for defined benefit medical plans) medical cost trend rates.

The projected unit credit method is an actuarial valuation method which sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. *IFRS for SMEs* does not require an entity to engage an independent actuary to perform the comprehensive actuarial valuation needed to calculate its defined benefit obligation. Nor does it require that a comprehensive actuarial valuation must be done annually. In the periods between comprehensive actuarial valuations, if the principal actuarial assumptions have not changed significantly, the defined benefit obligation can be measured by adjusting the prior period measurement for changes in employee demographics such as number of employees and salary levels. FRS 102 also adopts the same approach.

However, under *IFRS for SMEs*, in cases where the entity cannot use the projected unit credit method without undue cost or effort, the entity can:

- (i) Ignore estimated future salary increases;
- (ii) Ignore future service of current employees;
- (iii) Ignore possible in-service mortality of current employees between the reporting date and the date employees are expected to begin receiving post-employment benefits.

This simplified valuation method is not permitted by FRS 102.

## 64 Kayte (ACCA Exam Question 3, December 2014)

- (b) Report to the directors of Kayte: business implications of new UK GAAP, with particular reference to income tax

### *FRS 102 requirements*

A **current tax liability** is recognised for tax payable on taxable profit for the current and past periods. If the amount of tax paid for the current and past periods exceeds the amount of tax payable for those periods, the excess is recognised as a current tax asset.

A **current tax asset** is recognised for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.

A current tax liability/asset is measured at the amounts of tax the entity expects to pay/recover using the tax rates and laws that have been enacted or substantively enacted by the reporting date.

FRS 102 requires disclosure of the tax expense relating to discontinued operations.

Current tax assets and liabilities and deferred tax assets and liabilities are each offset **if, and only if, there is a legally enforceable right of set-off** and intention to settle on a net basis or simultaneously.

The FRS 102 approach to **deferred tax is similar to the old UK FRS 19 but not identical**. It is known as the **'timing differences plus'** approach, and has a small number of differences in detail.

Nor will the treatment be like that of IFRS or the *IFRS for SMEs*. The **section on income tax** in the *IFRS for SMEs* has been **completely replaced in FRS 102**. The concept underlying accounting for deferred tax is different under FRS 102 from the concept under the *IFRS for SMEs* (and full IFRS). Kayte would not be able to apply the temporary differences approach under FRS 102.

Under the *IFRS for SMEs* a 'balance sheet' approach is taken, based on **temporary differences**. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position.

By contrast, FRS 102 focuses on **timing differences**. These are differences between taxable profit and accounting profit that originate in one period and reverse in one or more subsequent periods. **Timing differences** arise because certain items are included in the accounts of a period which is different from that in which they are dealt with for taxation purposes. Under FRS 102 deferred taxation is the tax **attributable to timing differences**.

Both FRS 102 and the *IFRS for SMEs* **prohibit discounting** of deferred tax assets and liabilities.

### *Business implications*

Tax legislation for companies requires that the profits of a trade are calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes. Many entities will therefore see **a cash impact resulting from changes to tax**, which in turn arises from different treatments of, for example, goodwill, accounting profits and lease incentives. Transitional requirements will also affect the amount of distributable reserves.

Many **employee remuneration schemes**, such as bonuses and share-based payment, are **linked to profits**. **The profit figure will change, possibly significantly**, as a result of the move from 'old' to 'new' UK GAAP, and will in turn be affected by the amount of remuneration paid under such schemes. **Loans may also have to be re-negotiated** since the information provided to lenders will change.

There are **practical issues** to consider, such as training of the finance staff, possible recruitment of temporary staff to ease the transition, adequate information technology and accounting systems.

Last but not least, **effective and timely communication** to all stakeholders is important during the upheaval.

## 68 Decany (ACCA Exam Question 2, December 2011)

(a) (ii) **UK law and FRS 102 on requirements to produce group accounts**

Subject to certain exemptions, a parent entity should present consolidated financial statements in which it consolidates all its investments in subsidiaries in accordance with FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. A parent entity need only prepare consolidated accounts under the Act if it is a parent at the year end, as is the case with Ceed.

A parent is **exempt under the Companies Act** from the requirement to prepare consolidated financial statements on any one of the following grounds.

- (1) The parent is a wholly-owned subsidiary and its immediate parent is established under the law of an EEA State. Exemption is conditional on compliance with certain further conditions set out in section 400(2) of the Act.
- (2) The parent is a majority-owned subsidiary and meets all the conditions for exemption as a wholly-owned subsidiary set out in section 400(2) of the Act as well as the additional conditions set out in section 400(1)(b) of the Act.
- (3) The parent is a wholly-owned subsidiary of another entity and that parent is not established under the law of an EEA State. Exemption is conditional on compliance with certain further conditions set out in section 401(2) of the Act.
- (4) The parent is a majority-owned subsidiary and meets all of the conditions for exemption as a wholly-owned subsidiary set out in section 401(2) of the Act as well as the additional conditions set out in section 401(1)(b) of the Act.
- (5) The parent, and group headed by it, qualify as small as set out in section 383 of the Act and the group is not ineligible as set out in section 384 of the Act.
- (6) All of the parent's subsidiaries are required to be excluded from consolidation under the conditions set out below.
- (7) For a parent not reporting under the Act, if its statutory framework does not require the preparation of consolidated financial statements.

To qualify as a small company (Exemption (5) above), Ceed would need to satisfy **at least two** of the following criteria.

- Turnover not more than £6.5m
- Balance sheet total not more than £3.26m
- No more than 50 employees

Whether Ceed meets these criteria would **depend on the exchange rate**, but is easily determined. However, regardless of the small company exemption, **Ceed meets the s 400 exemption** in (1) above: since **all companies are incorporated in the UK**, it is 'a wholly-owned subsidiary and its immediate parent is established under the law of an EEA State'. Therefore **Ceed is not required to prepare group accounts** for itself and its subsidiary Rant.

## 72 Whitebirk (ACCA Exam Question 4, December 2010, amended)

(a) **UK reporting for small and medium-sized entities**

The main standard dealing with small and medium-sized entities in the UK is FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* which will ultimately replace all existing FRSS, SSAPs and UITF Abstracts. This is part of a new financial reporting framework, which will be effective on 1 January 2015. This framework is set out in FRS 100 *Application of Financial Reporting Requirements*.

Listed UK groups are required to prepare their consolidated financial statements in accordance with EU-adopted IFRS. FRS 101 *Reduced Disclosure Framework* permits disclosure exemptions from the requirements of EU-adopted IFRSs for certain qualifying entities. FRS 102 may be applied by any other entity or group, including parent and subsidiary companies within a listed group. A company applying FRS 102 is reporting under the **Companies Act**. FRS 102 can also be used by entities that are not companies and therefore not subject to company law.

The FRSSE (Financial Reporting Standard for Smaller Entities) will still be available for companies eligible to use it. FRS 100 makes some amendments to the FRSSE.

### Differences from the IASB's approach

FRS 102 is derived from the IASB's *IFRS for Small and Medium-sized Entities*, so in many ways, the approach adopted can be said to be similar. However, there are differences, deriving from the two main principles.

- (i) The IFRS for SMEs is a simplification of the principles in IFRS for recognising and measuring assets, liabilities, income and expenses. In many cases, this simplification is arrived at by removing options, that is keeping the simpler option and removing the more complicated one. It also contains fewer disclosures and is drafted more succinctly than IFRS.

Many commentators on FRED 44, the proposed FRS 102, supported simplification, but did not support the removal of options. Consequently, the ASB amended the IFRS for SMEs to **include accounting options in current FRS** and permitted by IFRS, but **not included in the IFRS for SMEs**.

- (ii) A company applying FRS 102 is reporting under the **Companies Act**. Some provisions of the Act **replace or amend** those of the IFRS for SMEs.

(b) (i) **Business combination**

IFRS 3 *Business combinations* allows an entity to adopt the full or partial goodwill method in its consolidated financial statements. The *IFRS for SMEs* **only allows the partial goodwill method**. This avoids the need for SMEs to determine the fair value of the non-controlling interests not purchased when undertaking a business combination.

In addition, IFRS 3 *Business combinations* requires goodwill to be tested annually for impairment. The *IFRS for SMEs* **requires goodwill to be amortised instead**. This is a much simpler approach and the *IFRS for SMEs* specifies that if an entity is unable to make a reliable estimate of the useful life, it is presumed to be ten years, simplifying things even further.

Goodwill on Whitebirk's acquisition of Close will be calculated as:

	\$'000
Consideration transferred	5,700
Non-controlling interest: 10% × \$6m	<u>600</u>
	6,300
Less fair value of identifiable net assets acquired	<u>(6,000)</u>
Goodwill	<u>300</u>

This goodwill of \$0.3m will be amortised over ten years, that is \$30,000 per annum.

(ii) **Research and development expenditure**

The *IFRS for SMEs* requires all internally generated research and development expenditure to be **expensed through profit or loss**. This is simpler than full IFRS – IAS 38 *Intangible assets* requires internally generated assets to be capitalised if certain criteria (proving future economic benefits) are met, and it is often difficult to determine whether or not they have been met.

Whitebirk's total expenditure on research (\$0.5m) and development (\$1m) must be written off to profit or loss for the year, giving a charge of \$1.5m.

(iii) **Investment property**

Investment properties must be held at fair value through profit or loss under the *IFRS for SMEs* where their fair value can be measured without undue cost or effort, which appears to be the case here, given that an estate agent valuation is available. Consequently a gain of \$0.2m (\$1.9m – \$1.7m) will be reported in Whitebirk's profit or loss for the year.

(iv) **Intangible asset**

IAS 36 *Impairment of assets* requires annual impairment tests for indefinite life intangibles, intangibles not yet available for use and goodwill. This is a complex, time-consuming and expensive test.

The *IFRS for SMEs* only requires impairment tests where there are indicators of impairment. In the case of Whitebirk's intangible, there are no indicators of impairment, and so an impairment test is not required.

(c) (i) **Business combination**

If Whitebirk applied FRS 102 instead of the *IFRS for SMEs*, the treatment of the business combination would be similar. FRS 102 **only allows the partial goodwill method and requires goodwill to be amortised** rather than tested annually for impairment.

(ii) **Research and development expenditure**

The *IFRS for SMEs* requires all internally generated research and development expenditure to be **expensed through profit or loss**. FRS 102 **permits a choice**. Development costs **may be written off, or they may be capitalised**.

In order to capitalise development costs Whitebirk would need to demonstrate that certain criteria relating to the asset had been met. These criteria are: technical feasibility, intention to complete, ability to use or sell, probable future economic benefits, availability of technical, financial and other resources to complete and ability to measure the attributable expenditure reliably.

If the above criteria are met, the development costs of £1m may be capitalised. However, the research costs of \$0.5m must still be written off to profit or loss.

(iii) **Investment property**

The treatment of the investment property would be unchanged under FRS 102.

(iv) **Intangible asset**

The treatment of the intangible asset would be unchanged under FRS 102.

### \*\*\* Apple (no equivalent in International Kit)

The rules on exclusion of subsidiaries in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* are based on but modify those in the Companies Act 2006. Under FRS 102, a subsidiary should be excluded from consolidation where:

- (a) **Severe long-term restrictions** substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary, or
- (b) The **interest in the subsidiary is held exclusively with a view to subsequent resale**; and the subsidiary has not previously been consolidated in the consolidated financial statements prepared in accordance with FRS 102. Such subsidiaries are required to be measured at fair value with changes recognised in profit or loss.

While severe long-term restrictions is one of the circumstances where exclusion is allowed, in the case of Orange, **control is not lost**, and so **it is not clear that Orange can be excluded** from consolidation.

The *IFRS for SMEs* is clearer on this issue. It **does not permit a parent to exclude from consolidation a subsidiary that operates under severe long-term restrictions** that significantly impair its ability to transfer funds to the parent. The existence of severe long-term restrictions does not preclude control under the *IFRS for SMEs*. In the case of Orange, **control has not been lost**, so **Orange must be consolidated**.

## 81 Case study question: Zippy (ACCA Exam Question 1, Sep/Dec 2016)

- (b) Amendments have been made to FRS 101 *Reduced Disclosure Framework*. An example of this is that an exemption is given from the IAS 24 *Related Party Disclosures* requirement to disclose the cost of key management personnel services provided by an entity. Additionally, changes have been made to ensure consistency with company law, principally to allow IFRS-type formats for the income statement and balance sheet. A new section has been added to FRS 102 *The Financial Reporting Standard applicable in the UK and the Republic of Ireland* named Section 1A 'Small entities'. Small entities are those which are eligible for the legal small company regime, the small LLP regime and others which would have been eligible if they had been incorporated. A statutory instrument has been introduced which increased the financial thresholds for small company qualification such that more companies will now qualify as small. Small entities which elect to adopt any of the three FRS 102 options (full FRS 102, FRS 102 with reduced disclosures or FRS 102 s.1A) are required to comply with the recognition and measurement rules of FRS 102. Those which adopt s.1A of FRS 102 are required to present a balance sheet, income statement and notes to the financial statements, but not a statement of comprehensive income, cash flow statement or statement of changes in equity. Section 1A includes a few disclosure requirements, but certain disclosure requirements under FRS 102 do not apply subject to the overriding requirement to give a true and fair view.

Other changes to FRS 102 bring FRS 102 into line with IFRS 2 *Share-based Payment*.

Other amendments to FRS 102 to achieve consistency with company law include greater flexibility in the choice of formats for the income statement and balance sheet, allowing IFRS-type formats and changes to the conditions for an intermediate parent to avail of the exemption from preparing consolidated financial statements. In particular, if that company's parent owns 90% or more of the allotted shares, the exemption is conditional on the remaining shareholders having approved the exemption. In the exceptional cases where an entity is unable to make a reliable estimate of the useful life of an intangible asset or goodwill, the life selected shall not exceed ten years whereas previously it was five years. The definition of related party is amended to include an entity which provides key management personnel services and also the reversal of impairment losses on goodwill is prohibited.

The Small Companies (Micro-entities' Accounts) Regulations 2013 (SI 2013/3008) introduced a new optional reporting framework for companies which meet the qualifying criteria of a micro-entity. FRS 105 *The Financial Reporting Standard applicable to the Micro Entities Regime* is the new accounting standard for those entities. The application of the micro-entities regime is optional but a micro-entity which chooses to prepare its financial statements in accordance with the micro-entities regime is required to apply FRS 105. A company which qualifies for this regime, but chooses not to apply it, is required to apply another accounting standard. The possible alternatives are set out in FRS 100 *Application of Financial Reporting Requirements*.

The requirements in the *IFRS for SMEs* relating to a bargain purchase have been amended in FRS 102 to comply with the Companies Act 2006.

## 82 Suntory (ACCA Exam Question 2, Sep/Dec 2016)

- (b) The objective of both IFRS for SMEs and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* as regards related party disclosures is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

However, there is a difference between them as in FRS 102, disclosures need not be given of transactions entered into between two or more members of a group, if any subsidiary, which is a party to the transaction, is wholly owned by such a member.

A person or a close member of that person's family is related to a reporting entity if that person:

- (i) Has control or joint control over the reporting entity
- (ii) Has significant influence over the reporting entity, or
- (iii) Is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

As regards Bobarra, the finance director is a related party, as he owns more than half of the voting power (60%). In the absence of evidence to the contrary, he controls Bobarra and is a member of the key management personnel. The sales director is also a related party of Bobarra as she is a member of the key management personnel and is a close member (spouse) of the family of the finance director. Their son is a related party of Bobarra as he is a close member (son) of their family. The operations director is also a related party as he owns more than 20% of the voting power in Bobarra. In the absence of evidence to the contrary, the operations director has significant influence over Bobarra and is a member of the key management personnel.

An entity is related to a reporting entity if the entity is controlled or jointly controlled by a person identified as a related party. Hence, the family trust is a related party of Bobarra. The family trust is controlled by related parties, the finance and sales directors, for the benefit of a close member of their family, i.e. their son. In the absence of evidence to the contrary, the third owner of the shares is not a related party. The person is a passive investor who does not appear to exert significant influence over Bobarra.

A related party relationship exists where the entity and the reporting entity are members of the same group, which means that each parent, subsidiary and fellow subsidiary is related to the others. Despite Alucant and Cantor being wholly owned subsidiaries of Bobarra, Drumby is not wholly owned by any member of the group and hence the intra-group transactions between Bobarra and Drumby must be made as related party disclosures. However, any transactions between Bobarra, Alucant and Cantor would be covered by the exemption from disclosure in FRS 102 even though the three entities are related parties.

## 83 Volutee (ACCA Exam Question 3, Sep/Dec 2016)

- (b) *IFRS for SMEs* requires intangible assets in a business combination to be recognised unless its fair value cannot be measured reliably without undue cost or effort but does not apply where the acquisition is not of a business. In this case, the acquisition was essentially that of an asset and therefore the measurement requirements relating to a business combination would not apply.

*IFRS for SMEs* states that an intangible asset should be measured initially at cost which is the purchase price including import duties and non-refundable purchase taxes and any directly attributable cost of preparing the assets for its intended use. Volutee should have recognised the tax payment as an expense in the statement of comprehensive income. Administrative and other general overhead costs are not attributable costs as they are indirect costs. The specific fiscal treatment and the tax to be paid were not linked to preparing the asset for its intended use, as the asset would have been used without the tax. As such, the tax is a cost linked to the activity of Volutee and should be accounted for as an expense and included in the profit or loss for the period, unless that tax arises from a transaction recognised outside profit or loss.

Under *IFRS for SMEs*, an entity measures intangible assets at cost less any accumulated amortisation and any accumulated impairment losses. All intangible assets are considered to have a finite useful life. If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years under both *IFRS for SMEs* and

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. However, FRS 102 states that an entity measures intangible assets after initial recognition using the cost model or the revaluation model. Where the revaluation model is selected, this is applied to all intangible assets in the same class. If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset is carried at its cost (or the revalued amount at the date of the last revaluation by reference to the active market) less any accumulated amortisation and impairment losses.

The revaluation model does not allow:

- (i) The revaluation of intangible assets which have not previously been recognised as assets, or
- (ii) The initial recognition of intangible assets at amounts other than cost.

Revaluations are made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.