Technical factsheet

Think Ahead ACCA

FRS 102 – reporting for medium-sized and large entities

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INTRODUCTION AND OVERVIEW OF UK GAAP

FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, has been in issuance since March 2013. For businesses which are not eligible to apply the small companies regime in the preparation of their financial statements, FRS 102 became mandatory for accounting periods commencing on or after 1 January 2015. This technical factsheet has been updated to incorporate the results of the triennial review completed by the FRC in 2017. The amendments arising from the triennial review are mandatory for accounting periods commencing on or after 1 January 2019. Early adoption is permissible provided all of the amendments are applied at the same time.

FRS 102 has its foundations built on the principles found in International Financial Reporting Standards (IFRSs), specifically *IFRS for SMEs*. *IFRS for SMEs* is intended to apply to general-purpose financial statements by entities which are classed as 'small and medium-sized' or 'private' and 'non-publicly accountable'. The term 'publicly accountable' was difficult to define in the context of legislation and hence is not a recognised concept in UK GAAP.

While FRS 102 is based on the principles found in *IFRS for SMEs*, the Financial Reporting Council (FRC) has modified the requirements significantly, both in terms of the scope of entities eligible to apply the standard and the accounting treatments provided. A notable area where the FRC has substantially modified the content of IFRS for SMEs to arrive at FRS 102 is in relation to Section 29 *Income Tax*, which is significantly different to the equivalent Section 29 in IFRS for SMEs. In addition, the FRC do not necessarily replicate all changes made by the International Accounting Standards Board (IASB) to IFRSs; for example, during the 2015 review of *IFRS for SMEs*, the IASB included an additional four undue cost or effort exemptions. During the triennial review, the FRC removed the undue cost or effort exemptions from FRS 102.

FRS 102 is divided into 'Sections' and each Section is organised by topic area. Cross-references to paragraphs within the standard are identified by section followed by paragraph number. Paragraph numbers are in the form of 'xx.yy', where 'xx' is the relevant section number and 'yy' is the sequential paragraph number within that section. Paragraphs which apply only to 'public benefit entities' are preceded by 'PBE'. Where FRS 102 provides examples of how certain principles are applied in the context of the standard which include monetary amounts, the measuring unit is the 'currency unit' (CU).

STANDARDS IN ISSUE

FRS 102 is part of a suite of standards that form current UK GAAP. The standards are listed below and the FRC issued revised editions of the standards in March 2018 which consolidate the triennial review amendments together with all other amendments made to the suite of UK GAAP since their introduction:

FRS 100 *Application of Financial Reporting Requirements*
FRS 101 *Reduced Disclosure Framework*
FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*
FRS 103 *Insurance Contracts*
FRS 104 *Interim Financial Reporting*
FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*

TRIENNIAL REVIEW AMENDMENTS

On 14 December 2017, the FRC issued the final amendments to FRS 102. With the exception of amendments to FRS 105 in respect of disclosures, all the other amendments must be applied mandatorily for accounting periods starting on or after 1 January 2019. Early adoption is permissible, provided that all the amendments are also early adopted. There are only two amendments which can be early adopted separately in respect of directors' loans (which will not apply to a medium-sized or large entity) and the gift aid accounting clarification (see below).

When FRS 102 was first issued in March 2013, the FRC indicated that they would review the standard every three years. This is consistent with the IASB's review of *IFRS for SMEs*. However, the Basis for Conclusions of FRS 102 (March 2018) confirms that periodic reviews of FRS 102 are likely to take place every four to five years to allow time for experience of the most recent edition of FRS 102 to develop before seeking stakeholder feedback. This should also allow stakeholders to provide more constructive feedback to the FRC in respect of any areas which are causing particular challenges or where clarifications/further amendments are needed.

That said, it is important to emphasise that should an emerging issue prove to be of an important nature, the FRC may deal with it as an ad-hoc project and amend FRS 102 (or other relevant standard) as appropriate after following the usual protocol (e.g. an Exposure Draft and applicable comment period). This approach will reduce the number of divergent practices.

An important point to emphasise is that the results of the triennial review should not be viewed as making 'wholesale' or significant changes by members. The majority of amendments are editorial in nature as well as providing clarification on certain technical points within the standards.

The amendments made to FRS 102 which are likely to affect medium-sized and large entities include the following:

Undue cost or effort exemptions

The FRC have removed the undue cost or effort exemptions in FRS 102 on the grounds that these were not being applied correctly. The FRC became aware that the undue cost or effort exemptions were being treated as accounting policy choices, which they were not. To some extent, the confusion may have arisen because the glossary to FRS 102 does not define ‘undue cost or effort’, although paragraph 2.14B of *IFRS for SMEs* defines the concept as:

‘Applying a requirement would involve undue cost or effort by an SME if the incremental costs (for example, valuers’ fees) or additional effort (for example endeavours by employees) substantially exceed the benefits that those that are expected to use the SME’s financial statements would receive from having the information.’

In some cases, the removal of an undue cost or effort exemption has been replaced by an accounting policy choice. This is particularly the case for groups which rent out property to another group member (see next). Areas of FRS 102 where undue cost or effort exemptions have been removed are:

- Section 14 *Investments in Associates* – paragraph 14.10
- Section 15 *Investments in Joint Ventures* – paragraph 15.15
- Section 16 *Investment Property* – paragraphs 16.1, 16.3, 16.4 and 16.10
- Section 17 *Property, Plant and Equipment* – paragraph 17.1(a)

Investment property within a group

To address implementation issues, the FRC have included an accounting policy choice for an entity which rents out investment property to another group entity. The accounting policy choice is in FRS 102 (March 2018), paragraph 16.4A.

FRS 102, Section 16 requires investment property to be remeasured to fair value at each reporting date with fair value changes going through profit or loss. Under previous UK GAAP, SSAP 19 *Accounting for investment properties* contained a scope exemption for groups which meant that properties rented to, or occupied by, group members, were not investment property for the purposes of either the separate financial statements or the group accounts. This scope exemption was not carried over into FRS 102 resulting in such properties having to be measured at fair value through profit or loss. Where group accounts were prepared, the fair value exercise was reversed and the property was reclassified to owner-occupied property to reflect the fact that group accounts reflect the economic substance of the group, which is that of a single reporting entity; hence all intra-group issues are eliminated.

To address implementation concerns by groups, the FRC have included paragraphs 16.4A and 16.4B in FRS 102 (March 2018) which offer an accounting policy choice. Property rented out to other group members can either be measured at fair value through profit or loss; or by using the cost model in Section 17 *Property, Plant and Equipment* (i.e. at cost less depreciation less impairment). It is expected that the latter model will be the most popular as this effectively restores the position in previous UK GAAP for groups.

It is emphasised that this accounting policy option only relates to **investment property rented to another group entity**. It does not apply to non-group investment property which must be measured at fair value through profit or loss at each balance sheet date (even for small companies).

Financial instruments

Financial instruments are possibly the most complex area of UK GAAP and FRS 102, Section 11 *Basic Financial Instruments* has seen some significant amendments to it through the triennial review. Prior to the triennial review, a financial instrument had to meet the detailed conditions outlined in paragraph 11.9 if the instrument were to be classed as basic. If the instrument did not meet the detailed conditions in paragraph 11.9, the instrument was non-basic and is therefore accounted for under the provisions in Section 12 *Other Financial Instruments Issues* which requires most financial instruments to be measured at fair value at each balance sheet date. There are examples at the foot of paragraph 11.9 to aid application of the conditions and the FRC have included additional examples as part of the triennial review to further aid an understanding.

As part of the triennial review amendments, the FRC have included a *description* of a basic financial instrument. Even if the financial instrument does not meet the conditions for classification as basic in paragraph 11.9, but it meets the description, then it can still be classed as basic and accounted for under Section 11. This will mean that for a relatively small number of financial instruments, they can be treated as basic rather than non-basic and use the amortised cost method which will provide relevant information for the users.

Therefore, entities must test the financial instrument against the detailed conditions in paragraph 11.9 first. If the instrument fails on the conditions, test against the description. If the instrument passes on the description, it can be classed as basic and hence accounted for under Section 11. If the instrument fails on both the detailed conditions *and* on the description, the instrument is non-basic and hence will be accounted for under Section 12.

The description of a basic financial instrument according to paragraph 11.9A is as follows:

> *'A debt instrument not meeting the conditions in paragraph 11.9 shall, nevertheless, be considered a basic financial instrument if it gives rise to cash flows on specified dates that constitute repayment of the principal advanced, together with reasonable compensation for the time value of money, credit risk and other basic lending risks and costs (eg liquidity risk, administrative costs associated with holding the instrument and lender's profit margin). Contractual terms that introduce exposure to unrelated risks or volatility (eg changes in equity prices or commodity prices) are inconsistent with this.'*

Accounting policy choice to apply IAS 39 *Financial Instruments*

FRS 102 has been amended to retain the option in Section 11 and Section 12 to apply the recognition and measurement requirements of IAS 39 *Financial Instruments.* The option is available until the impairment requirements in FRS 102 (Section 27 *Impairment of Assets*) are amended to reflect IFRS 9 *Financial Instruments*, or the FRC decide not to amend FRS 102 any further in respect of IFRS 9. The IAS 39 EU-carve out option also continues to be available.

In addition, FRS 102, paragraph 11.42 also requires an entity to disclose information which enables the users to evaluate the significance of financial instruments on the entity's financial position and performance. Therefore, an entity which has taken the accounting policy choice to apply the recognition and measurement requirements of IAS 39 or IFRS 9 may need to consider additional disclosures based on IFRS 7 *Financial Instruments: Disclosure*.

When the IASB finalised IFRS 9, amendments were also made to IFRS 7 *Financial Instruments: Disclosures* to reflect the new requirements in IFRS 9. Financial assets must be tested for impairment using an expected credit loss model (rather than an incurred credit loss model) and therefore the disclosure requirements of IFRS 7 were changed to reflect the recognition of expected credit losses. This means that some of the disclosures in FRS 102 are inconsistent with the application of the recognition and measurement requirements of IFRS 9 and hence a number of changes have been made to the disclosure requirements so as to ensure that when an entity applies the recognition and measurement principles of IFRS 9, they are providing relevant information concerning the impairment of financial assets.

Investments in shares

There was an anomaly in FRS 102 prior to the triennial review amendments. The September 2015 edition of FRS 102 required investments in non-convertible preference shares and non-puttable ordinary shares or preference shares to be measured at fair value, unless fair value cannot be measured reliably. Certain preference shares which are liabilities of the issuer (and measured at amortised cost) are treated differently by the holder.

Reference to such investments in shares in FRS 102 has been amended to 'non-derivative instruments which are equity of the issuer'. This improves the accounting for those instruments which are liabilities of the issuer as they are measured at amortised cost if the instrument is accounted for under Section 11 (i.e. it is basic).

Loans with two-way compensation clauses

The FRC issued commentary in June 2016 concerning the accounting for social housing loans; notably the classification of loans with two-way compensation clauses. Respondents did not agree that the inclusion of a description of a basic financial instrument (which has been included in FRS 102, paragraph 11.9A) sufficiently addressed the issue. To alleviate concerns in this respect, FRS 102, paragraph 11.9(c) has been amended which confirms that compensation could be paid by either the holder (the lender) or the issuer (the borrower).

Macro hedging

Fair value hedge accounting for a portfolio of financial instruments was not included in FRS 102 and therefore entities wishing to apply macro hedging applied the provisions in FRS 102, paragraph 11.2 (and 12.2) and used the recognition and measurement provisions in IAS 39/IFRS 9.

FRS 102 has been amended to cross-refer to the IAS 39 requirements for macro hedging.

Intangible assets

The definition of an intangible asset in FRS 102 is different than under previous UK GAAP and prior to the triennial review amendments gave rise to the need to recognise additional intangible assets that were acquired in a business combination (i.e. where a parent acquires a subsidiary). Feedback from groups indicated that this has increased costs of compliance in some instances, which the FRC have recognised goes against the principles of standard-setting.

The FRC decided to amend Section 18 *Intangible Assets other than Goodwill* so as to provide entities with an accounting policy choice of either separately recognising intangible assets acquired in a business combination or including them within goodwill. If the entity chooses to separately recognise intangible assets, they must apply this policy to all intangible assets in the same class and on a consistent basis (i.e. for all subsequent business combinations). Additional disclosures are also required which explain the nature of the intangible assets which have been separately recognised together with the reasons as to why they have been separately recognised.

FRS 102, paragraph 18.8 was heavily amended as part of the triennial review and the amended paragraph 18.8 states:

> *'Intangible assets acquired in a* ***business combination*** *shall be recognised separately from goodwill when all the following three conditions are satisfied:*
>
> *(a) the recognition criteria set out in paragraph 18.4 are met;*
>
> *(b) the intangible asset arises from contractual or other legal rights; and*
>
> *(c) the intangible asset is separable (ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or* ***liability****).*
>
> *An entity may additionally choose to recognise intangible assets separately from goodwill for which condition (a) and only one of (b) or (c) above is met. When an entity chooses to recognise such additional intangible assets, this policy shall be applied to all intangible assets in the same class (ie having a similar nature, function or use in the business), and must be applied consistently to all business combinations. Licences are an example of a category of intangible asset that may be treated as a separate class, however, further subdivision may be appropriate, for example, where different types of licences have different functions within the business.'*

Financial institutions

The definition of a financial institution in the glossary to FRS 102 has been amended to remove references to '… generate wealth or manage risk through financial instruments.' The removal of this phrase means there should be less uncertainty about how the definition should be applied and hence fewer entities will fall under the definition of a financial institution.

The glossary also provides a list of institutions that fall under the definition of a financial institution. The FRC have also removed 'retirement benefit plans' and 'stockbrokers' from the list, which will be a welcome change as they are not similar to the rest of the entities within the glossary's definition. In addition, retirement benefit plans are also subject to their own disclosure requirements in Section 34 *Specialised Activities*.

Key management personnel compensation

The requirement to disclose key management personnel compensation in totality is contained in FRS 102, paragraph 33.7. Paragraph 33.7A has been inserted by the FRC which states that when an entity is required to disclose directors' remuneration (or equivalent) under law or regulation, it is exempt from the requirement of paragraph 33.7 provided that key management personnel and the directors are the same.

Care needs to be taken where this is concerned, because the definition of 'key management personnel' is quite broad and includes all individuals who have authority and responsibility for planning, directing and controlling the entity, whether directly or indirectly. The definition includes directors (whether executive or otherwise) and so it may not necessarily be the case that key management personnel and the directors are the same body of individuals; although in a smaller entity, this could well be the case.

Net debt reconciliation

Many medium-sized entities are required to prepare a cash flow statement unless, for example, they claim exemption from preparing such a statement through a reduced disclosure framework (e.g. FRS 101 *Reduced Disclosure Framework* or the reduced disclosure framework in FRS 102). For those entities which are required to prepare a cash flow statement, the net debt reconciliation is introduced into FRS 102. This has been done on the grounds that the FRC consider the reconciliation provides useful information to users.

As preparers will already be familiar with the net debt reconciliation (it was a requirement of old FRS 1 (Revised 1996) *Cash flow statements*), the costs of compliance will be negligible and software providers will usually include this reconciliation within their accounts production software systems in any event.

Gift aid

Diversity in practice was emerging where a charitable parent which was within the scope of corporation tax had a trading subsidiary which made gift aid payments. In law, a gift aid payment is a distribution for accounting purposes, but a donation for tax purposes. Issues arose where there was no Deed of Covenant in place. Where a Deed of Covenant is in place, the treatment is less of an issue because the Deed of Covenant generally creates a legal obligation to make a gift aid payment to the charitable parent at the year end.

Gift aid payments are to be recognised as a distribution to owners as they are similar to dividends (i.e. they are recognised in equity). Similar principles to dividends also exist in respect of gift aid payments which are made after the balance sheet date. An expected gift aid payment must not be accrued unless a legal obligation to make the payment exists at the balance sheet date. A board decision to make a gift aid payment to a charitable parent prior to the balance sheet date is not sufficient to create a legal obligation.

When a subsidiary does not have a legal obligation to make a distribution of its profits to its owners at the balance sheet date, it will have taxable profits and hence will need to recognise an associated tax expense. FRS 102, paragraph 29.14 prohibits the tax effects of dividends being recognised before the dividend itself has been recognised.

FRS 102, paragraph 29.14A was inserted as part of the triennial review which states that when it is probable (i.e. more likely than not) that a gift aid payment will be made within nine months of the reporting date to the same charitable group, or charitable venturer, and the payment will qualify to be set against profits for corporation tax purposes, the tax effects of the gift aid payment can be accrued, but the gift aid payment cannot be accrued unless there is a legal obligation at the balance sheet date. The tax effects of the gift aid payment are recognised in profit and loss.

Fair value guidance

The fair value guidance which was contained in FRS 102, paragraphs 11.27 to 11.32 has been moved into the Appendix to Section 2 *Concepts and Pervasive Principles*.

Analysis of expenses

FRS 102, paragraph 5.11 required an entity to present an analysis of expenses using a classification based on either the nature or function of the expenses within the entity. This paragraph has been removed as it effectively duplicated the requirements in FRS 102, paragraph 5.5 as the profit and loss account formats in company law include requirements for the classification of expenditure.

Debt for equity swaps

FRS 102, paragraph 22.8A has been inserted to address concerns by stakeholders that FRS 102 was silent on the accounting for debt for equity swaps because, in some cases, such transactions can be significant. FRS 102, paragraph 22.8A states that no gain or loss is recognised in profit or loss as a result of a debt for equity swap if:

- the creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder;
- the creditor and the entity are controlled by the same party/parties both before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity; or
- the extinguishment is in accordance with the original terms of the financial liability.

Business combinations and group reconstructions
When a parent entity acquires a subsidiary, it is required to use the purchase method of accounting to account for the acquisition. The purchase method uses fair values to account for the assets acquired and liabilities and contingent liabilities assumed.

The purchase method outlined in FRS 102, paragraph 19.7 has been amended to include additional steps as a means of clarifying exactly what must happen for the purchase method of accounting to be applied correctly. In practice, the amendments are not expected to have any significant effects, but the amendments also mean that FRS 102, paragraph 19.7 is now consistent with the steps in IFRS 3 *Business Combinations*.

The definition of a group reconstruction has also been amended to incorporate, in certain circumstances, the transfer of a business in addition to the transfer of equity holdings.

Comparatives for disclosures only required by a SORP
The FRC have confirmed that when a disclosure is not required by FRS 102, but is required by a SORP, comparatives should be provided. Essentially, this is a clarification rather than an amendment.

For charities, reference should be made to the Charities SORP for any additional disclosure requirements. For example, the Charities SORP requires a statement on trustees' remuneration or expenses, even where there has been no trustees' remuneration or expenses paid in the period.

Going concern
While this is not an issue arising from the triennial review amendments, it is worthwhile emphasising the going concern considerations in FRS 102, paras 3.8, 3.9, 32.7A and 32.7B. FRS 102, para 3.8 requires management to make an assessment of the entity's ability to

continue as a going concern. An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. It must also be borne in mind that the going concern assessment must be for a period of **12 months** from **the date on which the financial statements are authorised for issue**. It is not 12 months from the reporting date.
Management must take into account all available information concerning the future when making their assessment of the entity's ability to continue as a going concern. Hence, if management intend to cease trading in, say, 18 months from the date on which the financial statements are authorised for issue, it would be inappropriate to prepare the financial statements on a going concern basis. The standard is clear – management must take into account all information about the future, which is at least, but is not limited to, 12 months from the date when the financial statements are authorised for issue.

FRS 102, paragraph 3.9 requires management to disclose **material uncertainties** relating to going concern in the financial statements. If the entity does not prepare financial statements on a going concern basis, it must disclose that fact, together with the basis on which it has prepared the financial statements as well as the reasons why the entity is not a going concern.

FRS 102, para 32.7A prohibits a reporting entity in preparing financial statements on a going concern basis if management determines *after* the reporting date that it intends to liquidate the entity or to cease trading, or that it has not realistic alternative but to do so.

FRS 102, para 32.7B confirms that deterioration in operating results and financial position after the reporting date may indicate a need to consider whether the going concern assumption is appropriate. When management conclude that the going concern assumption is no longer appropriate, the effect is so pervasive that FRS 102, Section 32 *Events after the End of the Reporting Period* would require a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis and hence the disclosure requirements of paragraph 3.9 would also apply.

TRANSITION TO FRS 102

The transitional issues that a first-time adopter of FRS 102 is required to apply are contained in Section 35 *Transition to this FRS*. Section 35 will apply to any reporting entity regardless of whether its previous accounting framework was EU-adopted IFRS or another set of generally accepted accounting principles (GAAP).

For companies that were previously small, but have become medium-sized and hence are required to apply the full provisions of FRS 102 as opposed to the presentation and disclosure requirements of Section 1A *Small Entities* (where Section 1A has been applied), there will not be any requirement to carry out another transition. This is because even though the company may have grown from small to medium-sized, the previously small entity would have had to apply the full recognition and measurement requirements of FRS 102. The difference will be in the disclosures needed in the financial statements as these will be based on full FRS 102, rather than Section 1A and therefore will be more comprehensive. With the exception of a small company that has grown into a medium-sized or large company, in practice, the transitional rules for a medium-sized company are only likely to apply to a company transitioning from IFRS or FRS 101 to FRS 102, or one that applied another local GAAP but is now required to report under FRS 102.

A first-time adopter of FRS 102 must apply Section 35 in the first set of financial statements which comply with FRS 102. An entity's 'first set of financial statements that comply with FRS 102' are those financial statements which contain an explicit and unreserved statement of compliance with FRS 102. FRS 102, paragraph 35.4 provides three examples of when financial statements prepared under the principles of FRS 102 are an entity's first such financial statements as follows (note b) below reflects the slight amendment to paragraph 35.4(b) as part of the triennial review):

a) the entity did not present financial statements for previous periods;
b) the entity presented its most recent previous financial statements under previous UK and Republic of Ireland requirements that are not consistent with FRS 102 in all respects; or
c) the entity presented its most recent previous financial statements in conformity with EU-adopted IFRS.

The standard requires an entity to disclose comparative information in respect of the previous accounting period for all amounts presented in the financial statements and specified comparative narrative and descriptive information. The majority of reporting entities in the UK and Republic of Ireland will provide current year financial information and the previous period's/year's comparatives; however, the standard does permit an entity to present more than one preceding period (although in practice this is not usually the case).

Where an entity is applying FRS 102 for the first time and only presents one preceding period of comparative information, the entity will need to make adjustments to:

- the comparative statement of financial position (balance sheet);
- the comparative income statement/statement of comprehensive income (profit and loss account and other comprehensive income); and
- the opening statement of financial position (balance sheet) at the date of transition. The opening balance sheet at the date of transition is not required to be disclosed in the first set of financial statements prepared under FRS 102.

The transition procedures can be looked at as a series of five steps:

Step 1: determine the date of transition
Step 2: recognise all assets and liabilities whose recognition is required by FRS 102
Step 3: derecognise items as assets or liabilities if FRS 102 does not permit such recognition
Step 4: reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under FRS 102
Step 5: apply FRS 102 in measuring all recognised assets and liabilities.

The rules in FRS 102 are retrospective and they have to be applied as far back as the date of transition (i.e. to the opening balance sheet position at the start date of the earliest period reported in the accounts) and then to the comparative period/year end. The objective of this restatement process is to enable the financial statements to reflect the provisions in FRS 102 as if the standard had always been the entity's financial reporting framework used by the entity. Retrospective application will enable the financial statements to be both comparable and consistent because otherwise it would be meaningless to have the current year's financial statements prepared under FRS 102, with the previous period prepared under the entity's previous financial reporting framework. Retrospective restatement is needed as far back as the date of transition so that the opening balances, on which the comparative year is built, reflect the provisions in FRS 102.

While Section 35 outlines the accounting requirements for the reporting entity's opening balance sheet position, it does not require the opening balance sheet to be presented (unlike the equivalent IFRS 1 *First-time Adoption of International Financial Reporting Standards*).

Transitional versus prior period adjustments

It should be noted that the accounting policies which an entity uses in its opening balance sheet under FRS 102 could differ from those which it used as at the same date under its previous financial reporting framework. This is because the entity's previous financial reporting framework may have permitted certain accounting treatments, whereas FRS 102 may not permit such accounting treatments and vice versa. Any adjustments which are made to the entity's opening balance sheet position as a result of aligning accounting policies to achieve compliance with FRS 102 are generally known as 'transitional adjustments'.

With the exception of some specified exemptions, the rules must be applied to the prior period comparative financial statements and these adjustments are generally referred to as 'prior period (or prior year) adjustments'. It is important to distinguish between the two types of adjustments. Some examples of adjustments which might be made to a category of equity, other than retained earnings, include:

- amounts in respect of remeasuring derivative financial instruments which are subject to hedge accounting under Section 12 *Other Financial Instruments Issues*;
- any difference between the cost of an item of property, plant and equipment and fair value where the entity uses a deemed cost, or where a policy of revaluing the asset(s) is adopted on transition to FRS 102; and
- deferred tax that is recognised for the first time on items of property, plant and equipment measured under the revaluation model and which has been included in the same reserve as the revaluation gain.

Determining the date of transition

The date of transition is the start date of the earliest period reported in the financial statements.

Example 1: Determining the date of transition

Company A Ltd is preparing its first set of FRS 102 financial statements for its year ended 31 March 2019 and the financial controller is unsure as to the entity's date of transition. The company only includes the preceding year's financial statements as comparatives.

The date of transition is the start date of the earliest period reported in the accounts. The comparative year ended on 31 March 2018 which started on 1 April 2017; therefore 1 April 2017 is the entity's date of transition.

Company B Ltd is preparing its first set of FRS 102 financial statements for its year ended 31 July 2019 and the accounts senior is unsure as to the entity's date of transition. The company only includes the preceding year's financial statements as comparatives.

In Company B's case, the date of transition will be 1 August 2017, being the start date of the earliest period reported in the financial statements.

Mandatory exceptions from retrospective application

FRS 102, paragraph 35.9 prohibits a first-time adopter from retrospectively changing the accounting which it followed under its previous GAAP for any of the following types of transactions:

Derecognition of financial assets and financial liabilities

Where financial assets and financial liabilities were derecognised under the entity's previous financial reporting framework prior to the date of transition, they are not to be recognised on transition to FRS 102. Also, where a financial asset or a financial liability (or group of financial assets and financial liabilities) would have been derecognised under FRS 102 in a transaction which took place prior to the date of transition, but which have not been derecognised under its previous financial reporting framework, the entity can either derecognise them on first-time adoption of FRS 102, or continue to recognise them until they are either disposed of or settled.

Accounting estimates

Accounting estimates at the date of transition cannot be changed for the benefit of hindsight. Therefore, if the reporting entity had a provision for liabilities at its date of transition, but now knows the outcome of the event or condition that gave rise to that provision, it cannot retrospectively change the amount of the estimate (unless it was clearly a material error).

Non-controlling interests

The entity must not retrospectively change the accounting which it followed under previous UK GAAP for measuring non-controlling interests (referred to as 'minority interests' in previous GAAP). The requirements to:

- allocate profit or loss and total comprehensive income between non-controlling interests and owners of the parent,
- account for changes in the parent's ownership interest in a subsidiary which do not result in a loss of control, and
- account for a loss of control over a subsidiary,

must be applied prospectively from the date of transition to FRS 102, or from such earlier date as FRS 102 is applied to restate business combinations. (See the next section of this technical factsheet, 'Optional exemptions from retrospective application'.)

Optional exemptions from retrospective application

FRS 102, paragraph 35.10 contains 18 optional exemptions from retrospective application which a first-time adopter may wish to take advantage of in its first set of FRS 102 financial statements.

In respect of the optional exemptions, an entity can take advantage of all, some or none of them as applicable. In the vast majority of cases, it is unlikely that a reporting entity will be able to take advantage of all of the optional exemptions.

Business combinations, including group reconstructions

A first-time adopter does not have to apply Section 19 *Business Combinations and Goodwill* to those business combinations which took place before the date of transition to FRS 102. However, where the entity restates any business combination so as to comply with Section 19, it must restate all later business combinations. Where the provisions in Section 19 are not applied retrospectively, all assets and liabilities acquired or assumed in a past business combination at the date of transition will be recognised and measured in accordance with paragraphs 35.7 to 35.9 (or, if applicable, paragraphs 35.10(b) to (v)).

There are, however, two exceptions in respect of:

- intangible assets (not goodwill): intangible assets subsumed within goodwill must not be recognised separately
- goodwill: no adjustment is made to the carrying amount of goodwill.

Share-based payment transactions

For equity instruments granted before the date of transition, a first-time adopter does not have to apply Section 26 *Share-based Payment*. This exemption also applies to liabilities arising from share-based payment transactions which were settled prior to the date of transition.

Where a first-time adopter has previously applied either FRS 20 *Share-based Payment* or IFRS 2 *Share-based Payment* to equity instruments granted BEFORE the date of transition, the entity must then apply FRS 20/IFRS 2 (as applicable) or Section 26 at the date of transition.

Fair value as deemed cost

For items of property, plant and equipment (Section 17 *Property, Plant and Equipment*), investment property (Section 16 *Investment Property*) or intangible assets excluding goodwill (Section 18 *Intangible Assets other than Goodwill*), a first-time adopter can use fair value as deemed cost on transition to FRS 102. The term 'deemed cost' is defined in the glossary as:

'*An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent* ***depreciation*** *or* ***amortisation*** *assumes that the entity had initially recognised the* ***asset*** *or* ***liability*** *at the given date and that its cost was equal to the deemed cost*.'

Revaluation as deemed cost (see example 2 below)

For items of property, plant and equipment, investment property or intangible assets other than goodwill, a first-time adopter can use a revaluation amount as deemed cost. This may be of particular benefit to a client who wants to stop getting periodic revaluations and move back onto the cost model for its property, plant and equipment. Care must be taken with this exemption because the valuations used as deemed cost must be either at the date of transition or before the date of transition, but not after.

Individual and separate financial statements

FRS 102, paragraphs 9.26, 14.4 and 15.9 require an entity to account for investments in subsidiaries, associates and jointly controlled entities either at cost less impairment or at fair value in the individual or separate financial statements. Where cost is used, the first-time adopter must use one of the following amounts in the individual/separate opening balance sheet:

- cost per Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Investments in Joint Ventures*, or
- deemed cost – in this respect the deemed cost is the carrying amount at the date of transition which has been determined under its previous financial reporting framework.

Compound financial instruments
'Split accounting' is used for compound financial instruments (where the debt and equity components of the instruments are accounted for separately). A first-time adopter does not have to use split accounting if the liability portion of the instrument has been settled at the date of transition.

Service concession arrangements
A service concession arrangement is defined in the glossary as:

'*An arrangement whereby a public sector body or a **public benefit entity** (the grantor) contracts with a private sector entity (the operator) to construct (or upgrade), operate and maintain **infrastructure assets** for a specified period of time (the concession period)*.'

For such arrangements, a first-time adopter does not have to apply the provisions in paragraphs 34.12I to 34.16A for service concession arrangements entered into prior to the date of transition as these arrangements will continue to be accounted for using the same accounting policies applied at the date of transition.

Extractive industries
Where a first-time adopter has previously accounted for exploration and development costs for oil and gas properties which are in the development/production phase in cost centres that included all properties in a large geographical area, it can choose to measure oil and gas assets at the date of transition on the following basis:

- exploration and evaluation assets at the amount determined under its previous financial reporting framework
- assets in the development/production phase at the amount determined for the cost centre under its previous financial reporting framework. (This amount will be

allocated to the cost centre's underlying assets on a pro-rata basis using reserve volumes or values at the date of transition).

First-time adopters must test exploration and evaluation assets in the development and production phases for impairment at the date of transition in accordance with either Section 34 *Specialised Activities* or Section 27 *Impairment of Assets*.

Arrangements containing a lease

First-time adopters can choose to determine whether an arrangement that exists at the date of transition contains a lease on the basis of facts and circumstances existing at the date of transition, rather than when the lease was originally entered into.

Decommissioning liabilities included in the cost of property, plant and equipment (PPE)

The cost of an item of PPE should include the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. A first-time adopter can choose to measure this portion of the cost at the date of transition rather than on the date(s) when the obligation initially arose.

Dormant companies

A company which is dormant (as defined in the Companies Act 2006) can retain its accounting policies for reported assets, liabilities and equity at the date of transition until such time that there is a change to those balances or the company enters into new transactions.

Deferred development costs as deemed cost

The carrying amount of development costs capitalised under the entity's previous reporting framework can be used as deemed cost on transition to FRS 102.

Lease incentives

A first-time adopter does not have to apply paragraphs 20.15A and 20.25A to lease incentives provided that the lease was entered into before the date of transition. The first-time adopter can continue to recognise any remaining lease incentive (or cost associated with lease incentives) on the same basis as that applied at the date of transition to FRS 102.

Public benefit entity combinations

A first-time adopter does not have to apply paragraphs PBE34.75 to PBE34.86 to public benefit combinations which had taken place prior to the date of transition. However, if the first-time adopter restates any entity combination to comply with FRS 102, it must restate all later entity combinations.

Assets and liabilities of subsidiaries, associates and joint ventures

When a subsidiary becomes a first-time adopter later than its parent, the subsidiary measures its assets and liabilities at either:

1. the carrying values that would be included in the parent's consolidated accounts. These values are based on the parent's date of transition to FRS 102 if no consolidation adjustments were made and for the effects of the business combination in which the parent acquired the subsidiary, or
2. the carrying values required by the rest of FRS 102 which are based on the subsidiary's date of transition.

The carrying values in 2 could be different from in 1 where the exemptions result in measurements which are dependent on the date of transition. In addition, differences could arise where the accounting policies used by the subsidiary differ from those in the consolidated accounts.

Similar exemptions are available for an associate or joint venture which become a first-time adopter later than the entity which holds significant influence or joint control over it.

Conversely, where the parent or investor becomes a first-time adopter later than its subsidiary, associate or joint venture, the parent/investor will, in the consolidated financial statements, measure the assets and liabilities of the subsidiary, associate or joint venture at the same carrying value as in the subsidiary's associate's or joint venture's financial statements which takes into account consolidation and equity accounting adjustments as well as the effects of the business combination in which the parent acquired the subsidiary or transaction in which the entity acquired the associate or joint venture.

Where the parent becomes a first-time adopter in respect of its separate financial statements earlier or later than for its consolidated accounts, the parent measures its assets and liabilities at the same value in both sets of accounts, except for consolidation adjustments.

Designation of previously recognised financial instruments

FRS 102 allows a financial instrument to be designated on initial recognition as a financial asset or financial liability at fair value through profit or loss, provided certain criteria are met. A first-time adopter can designate any financial asset or financial liability at fair value through profit or loss provided the asset or liability meets the criteria in paragraph 11.14(b) at the date of transition.

Hedge accounting

There are exemptions available in respect of hedge accounting which may be applied in respect of:

- a hedging relationship existing at the date of transition
- a hedging relationship which ceased to exist at the date of transition because the hedging instrument had expired, was sold, terminated or exercised prior to the date of transition
- a hedging relationship which commenced subsequent to the date of transition
- entities which choose to take the accounting policy choice under paragraphs 11.2(b) or (c) or paragraphs 12.2(b) or (c) and apply IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*.

Example 2: Revaluation as deemed cost

Company A Ltd is applying FRS 102 for the first time in its financial statements for the year ended 31 July 2019. Under its previous financial reporting framework it always measured its freehold buildings using the revaluation model and obtained updated valuations every five years as well as valuations in the intervening years where evidence suggested there had been a material change in value.

The board of directors have decided that the use of the revaluation model is no longer appropriate for the business and have enquired as to whether they can measure the freehold buildings using the historic cost model under FRS 102.

Under the entity's previous financial reporting framework, a change from the cost model to the revaluation model would have been classed as a change in accounting policy (as it would be under FRS 102 principles). An accounting policy can only be voluntarily changed by an entity if the change results in the financial statements providing reliable and more relevant information and it is generally accepted that regular valuations are more reliable than measuring under the cost model. In view of this principle, ordinarily, it is inherently difficult to switch back from the revaluation model to the historic cost model because an entity would struggle to justify how the cost model provides more relevant and reliable information over up-to-date valuations.

However, in Company A's situation, the company is transitioning to a whole new financial reporting framework and hence it is possible to use a revalued amount as deemed cost (as per FRS 102, paragraph 35.10(d)) provided the date of the valuation is either at, or before, the date of transition. Valuations cannot be obtained after the date of transition and then be used as deemed cost. Advance planning is advisable where an entity wishes to take advantage of revaluations as deemed cost to ensure an appropriate valuation is obtained.

WORKED EXAMPLE: TRANSITION TO FRS 102

Largeco Ltd is applying FRS 102 for the first time in its financial statements for the year ended 30 April 2019 having previously reported under another national GAAP. The date of transition to FRS 102 is 1 May 2017 and the opening balance sheet position as at that date is shown below:

Largeco Ltd

Trial balance as at 1 May 2017	**Note**	**Dr**	**Cr**
Plant and machinery		104,801	
Plant and machinery depreciation			34,926
Fixtures and fittings		308,987	
Fixtures and fittings depreciation			158,604
Investment property	1	206,650	
Stock		11,383	
Trade debtors		5,170,736	
Prepayments		49,649	
Interest-free loan to subsidiary company	2	2,600,000	
Cash at bank and in hand		3,139,556	
Trade creditors			1,959,141
Corporation tax			617,197
Sundry creditors			59,259
Deferred income			95,198
Accrued expenses	3		1,639,113
Director's loan account due after more than 1 year	4		691,603
Deferred tax			10,420
Share capital			100
Revaluation reserve			85,200
Retained earnings			6,241,001
		11,591,762	11,591,762

Notes

1. Under the entity's previous financial reporting framework, increases in the value of investment property were taken to a revaluation reserve. The valuation as at 1 May 2017 reflects the valuation obtained from a local firm of chartered surveyors as at

30 April 2017. The directors do not want to present a separate reserve in respect of any non-distributable reserves and the directors do not anticipate selling the investment property in the foreseeable future.

2. There are no formal loan terms attached to the loan to the subsidiary company.

3. Largeco's holiday year is not coterminous with its year end. The payroll department has calculated that an amount of £14,200 was due to employees at the year end in respect of accrued holiday pay. The company has previously not accounted for unpaid holiday entitlement accrued at the year end.

4. The director's loan account represents funds introduced by the director who is also the majority shareholder of the business. The director does not consider the loan to be repayable in the foreseeable future and the loan has been classed as long-term under its previous financial reporting framework. There are no formal terms attached to the loan and no interest payments are made to the director.

FRS 102, paragraph 35.7 says that an entity shall, in its opening statement of financial position (balance sheet) as at the date of transition:

a. recognise all assets and liabilities whose recognition is required by this FRS;
b. not recognise items as assets or liabilities if this FRS does not permit such recognition;
c. reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under this FRS; and
d. apply this FRS in measuring all recognised assets and liabilities.

The entity is required to consider its accounting policies and determine whether they are compliant with the requirements of FRS 102. Where such policies may have been permissible under the entity's previous financial reporting framework, but are not permissible under FRS 102, they must be changed retrospectively to the date of transition as well as in the comparative financial statements.

In Largeco's case, there are four matters which must be dealt with at the date of transition in order that the opening balance sheet position at the date of transition is compliant with FRS 102. These are dealt with as follows:

Note 1: investment property

The investment property was previously revalued with revaluation movements being taken to the revaluation reserve. The accounting treatment for investment properties is different under FRS 102 because all fair value gains and losses must be reported within profit or loss (note: even though FRS 102 does not recognise the concept of 'operating profit', such gains and losses should be regarded as operating gains/losses where an operating profit line is used on the face of the profit and loss account). As the fair value accounting rules are being applied under FRS 102, all gains and losses are taken to profit and loss.

The transitional adjustments needed are as follows:

	£
Dr Revaluation reserve	85,200
Cr Retained earnings	85,200

Being reallocation of revaluation reserve in respect of the investment property.

Where transitional adjustments are concerned, corresponding entries are taken to profit and loss account reserves (retained earnings) as per FRS 102, paragraph 35.8.

Note: an alternative treatment would be to present such gains (which are non-distributable) within a separate reserved called the 'Non-distributable reserve' to ring-fence those gains which are not available for distribution to the shareholders. There is nothing in company law which requires this treatment, but it may be advisable to have a separate reserve to take unrealised gains to prevent them from being inappropriately distributed to shareholders.

FRS 102, paragraph 29.16 requires deferred tax to be brought into consideration where investment properties are concerned to comply with Section 29 *Income Tax*. The directors do not envisage selling the investment property in the foreseeable future, and paragraph 29.16 requires deferred tax in respect of investment property to be measured using the tax rates and allowances that apply to the sale of the asset. Therefore, if it is assumed the tax rate which will apply to the sale is 17%, deferred tax (excluding the effects of indexation which may be available) is recognised on the investment property at the date of transition as follows:

	£
Dr Retained earnings	14,484
Cr Deferred tax provision	14,484

Being deferred tax on the investment property revaluation (£85,200 x 17%).

Note: if Largeco Ltd were to recognise unrealised gains and losses in a separate reserve, the debit would have been taken to that specific reserve. The concept of 'tax treatment follows accounting treatment' applies in respect of deferred tax.

The net gain of £70,716 (£85,200 less £14,484) must not be distributed to shareholders because it is an unrealised gain. Gains only become realised gains when they are readily convertible into cash, and a fair value gain on investment property is not readily convertible into cash.

Note 2: interest-free loan to subsidiary company

There are no specific terms attached to the loan made to the subsidiary company.

As there are no specific terms attached to this loan, the default presumption in FRS 102 is that the loan is repayable on demand and hence it is to be treated as such in the balance sheet on transition, in the prior year and going forward. While this may not be such an issue for Largeco, if the subsidiary has classified the loan as a long-term liability, it would have to move it up to current liabilities in its balance sheet. This will reduce the value of the subsidiary's net current assets, or turn net current assets into net current liabilities or even increase net current liabilities. This is an important planning point prior to the transition as reallocating loans from long-term to current may impact credit ratings and the views of lenders and creditors.

Note 3: holiday pay accruals

The holiday year at Largeco is not coterminous with its year end. It is not always advisable to align the holiday year with the financial year simply for financial reporting purposes and in situations where the holiday year is not aligned to the accounting reference date, holiday pay accruals will be needed to comply with the requirements of Section 28 *Employee Benefits*. It is also to be noted that it is possible that holiday pay prepayments might be recognised depending on where the entity's holiday year is in relation to the financial year.

In the example, the payroll department has calculated that an amount of £14,200 was due to employees as at 30 April 2017 and that this amount had not previously been recognised. Therefore, the transitional adjustments are as follows:

	£
Dr Retained earnings	14,200
Cr Accruals	14,200

Being holiday pay accruals as at 30 April 2017 for date of transition as at 1 May 2017.

Tax implications have been ignored for the purposes of this example, but would be brought into account if the holiday pay accrual is paid within nine months of the year-end date (as corporation tax relief is granted in such situations) so would effectively give rise to a deferred tax asset.

Note 4: director's loan account

The director (who is also the majority shareholder) has made a loan to the business amounting to £691,603.

The loan has no formal terms attached to it but has been regarded as a long-term liability in previous accounting periods. In the absence of any specific terms, this treatment is not possible under FRS 102 because loans without specific terms attached would be regarded as being repayable on demand (in much the same way as the loan discussed in note 2 above). A transitional adjustment is needed to reflect the on-demand feature of the loan as follows:

	£
Dr Long-term liabilities	691,603
Cr Director's current account (current liabilities)	691,603

Being reallocation of director's current account to current liabilities.

Following the incorporation of the above transitional adjustments, Largeco's opening trial balance at the date of transition will look as follows (overleaf):

Largeco Ltd

Trial balance as at 1 May 2017	**Dr**	**Cr**
Plant and machinery	104,801	
Plant and machinery depreciation		34,926
Fixtures and fittings	308,987	
Fixtures and fittings depreciation		158,604
Investment property	206,650	
Stock	11,383	
Trade debtors	5,170,736	
Prepayments	49,649	
Interest-free loan to subsidiary company	2,600,000	
Cash at bank and in hand	3,139,556	
Trade creditors		1,959,141
Corporation tax		617,197
Sundry creditors		59,259
Director's loan account (current)		691,603
Deferred income		95,198
Accrued expenses		1,653,313
Deferred tax		24,904
Share capital		100
Retained earnings		6,297,517
	11,591,762	11,591,762

Retained earnings have increased by £56,516 (£6,241,001 less £6,297,517) and the increase is reconciled as follows:

	£
Retained earnings under previous UK GAAP	6,241,001
Reallocation of investment property revaluation reserve	85,200
	6,326,201
Additional deferred tax recognised on investment property revaluation	(14,484)
Holiday pay accruals	(14,200)
Retained earnings under FRS 102	6,297,517

Prior year adjustments

Adjustments are made to the opening balance sheet position so that the ‘starting point’ within the first FRS 102 financial statements are compliant with the requirements of the standard. As financial statements will include the previous year as comparative figures, those comparatives must also be restated so they reflect the provisions in FRS 102.

Continuing with the example of Largeco above, the trial balance as at 30 April 2018 prepared under previous UK GAAP is shown overleaf:

Largeco Ltd: trial balance as at 30 April 2018	Note	Dr	Cr
Plant and machinery		104,801	
Plant and machinery depreciation			48,901
Fixtures and fittings		308,987	
Fixtures and fittings depreciation			196,200
Investment property	1	226,650	
Stock		13,383	
Trade debtors		2,157,259	
Prepayments		47,935	
Interest-free loan to subsidiary company	2	2,600,000	
Cash at bank and in hand		8,184,949	
Trade creditors			627,931
Corporation tax			1,759,223
Sundry creditors			61,300
Deferred income			95,196
Accrued expenses	3		1,501,024
Directors loan account due after more than one year	4		691,603
Deferred tax			21,904
Share capital			100
Revaluation reserve			20,000
Retained earnings			6,297,517
Sales			27,164,856
Other income			2,936
Opening stock		11,383	
Cost of sales		19,678,634	
Closing stock			13,383
Freight and carriage		285,219	
Directors' remuneration		200,000	
Directors' employer NIC		27,600	
Administrative staff salaries	3	417,812	
Administrative staff employer's NIC		39,112	
Commission paid		312,500	
Staff recruitment expenses		11,250	
Light and heat		27,225	
General rates		31,500	
Postage and stationery		5,674	
Travel and subsistence		8,540	
Advertising		9,554	
Repairs and renewals		9,315	
Computer costs		6,317	
Legal fees		1,166	
Accountancy and audit		15,400	
Bank charges		2,311	
Finance costs		1,375	
Tax		1,756,223	
Dividends to ordinary shareholders		2,000,000	
		38,502,074	38,502,074

Summary financial statements based on the above trial balance are as follows:

Balance sheet

	£	£
Fixed assets	395,337	
Current assets	13,003,526	
Liabilities		4,736,277
Provisions for deferred tax		21,904
Equity and reserves		8,640,682
	13,398,863	13,398,863

Profit and loss account

	£
Turnover	27,164,856
Other income	2,936
Cost of sales	(19,676,634)
Distribution costs	(285,219)
Administrative expenses	(1,125,276)
Finance costs	(1,375)
Profit before tax	6,079,288
Tax	(1,756,223)
Profit after tax	4,323,065

Adjustments will also have to be made to the prior year balances so that they reflect the provisions in FRS 102 as follows:

Note 1: investment property

The investment property has seen a fair value gain as at 30 April 2018 of £20,000. The entries in the comparative year under the entity's previous financial reporting framework were:

Dr Investment property	£20,000
Cr Revaluation reserve	£20,000

A prior year adjustment will have to be done to reflect the provisions of Section 16 in FRS 102 as follows:

Dr Revaluation reserve	£20,000
Cr Fair value adjustments (P&L)	£20,000

Being reallocation of revaluation gain in the year to 30 April 2018.

An additional deferred tax liability will have to be recognised on the fair value gain. If it is assumed the rate of tax applied on the sale of the asset at 30 April 2018 will be 17%, the deferred tax liability is calculated at £3,400 (£20,000 x 17%) and the prior year adjustment will be:

Dr Tax expense	£3,400
Cr Deferred tax provision	£3,400

Being deferred tax on revaluation gain to 30 April 2018.

Note 2: interest-free loan to subsidiary

This loan will continue to be treated as a current asset in Largeco's balance sheet because there are no terms attached to the loan and hence it is treated as being repayable on demand. The loan in the subsidiary's financial statements will be shown as a current liability to reflect the on-demand feature of the loan.

Note 3: holiday pay accrual

The payroll department has calculated that an amount of £15,100 was due to the administration staff in respect of holiday pay accrued but not paid as at 30 April 2018. The provision at the date of transition was £14,200 resulting in an additional provision of £900 (£15,100 – £14,200) to be recognised as at 30 April 2018.

The prior year adjustment will be:

Dr Administrative staff salaries	£900
Cr Accruals	£900

Being holiday pay accrual as at 30 April 2018.

Tax implications have been ignored for the purposes of this example but would be brought into account if the holiday pay has been paid within nine months of the year end.

Note 4: director's loan account

As the loan made to the director-shareholder does not have any formal terms attached to it, this must also be regarded as repayable on demand in the prior year financial statements. A prior year adjustment must be made to reallocate the loan from long-term liabilities to current liabilities as follows:

Dr Long-term liabilities	£691,603
Cr Current liabilities (director's current account)	£691,603

Being reallocation of director's current account in the prior year.

Once the above prior year adjustments have been put through, the trial balance will be as follows (overleaf):

Largeco Ltd: trial balance as at 30 April 2018	Dr	Cr
Plant and machinery	104,801	
Plant and machinery depreciation		48,901
Fixtures and fittings	308,987	
Fixtures and fittings depreciation		196,200
Investment property	226,650	
Stock	13,383	
Trade debtors	2,157,259	
Prepayments	47,935	
Interest-free loan to subsidiary company	2,600,000	
Cash at bank and in hand	8,184,949	
Trade creditors		627,931
Corporation tax		1,759,223
Sundry creditors		61,300
Directors loan account		691,603
Deferred income		95,196
Accrued expenses		1,501,924
Deferred tax		25,304
Share capital		100
Retained earnings		6,297,517
Sales		27,164,856
Other income		2,936
Opening stock	11,383	
Cost of sales	19,678,634	
Closing stock		13,383
Freight and carriage	285,219	
Directors' remuneration	200,000	
Directors' employer NIC	27,600	
Administrative staff salaries	418,712	
Administrative staff employer's NIC	39,112	
Commission paid	312,500	
Staff recruitment expenses	11,250	
Fair value movement on investment property		20,000
Light and heat	27,225	
General rates	31,500	
Postage and stationery	5,674	
Travel and subsistence	8,540	
Advertising	9,554	
Repairs and renewals	9,315	
Computer costs	6,317	
Legal fees	1,166	
Accountancy and audit	15,400	
Bank charges	2,311	
Finance costs	1,375	
Tax	1,759,623	
Dividends to ordinary shareholders	2,000,000	
	38,506,374	38,506,374

Summary financial statements based on the above trial balance are as follows:

Balance sheet	£	£
Fixed assets	395,337	
Current assets	13,003,526	
Liabilities		4,737,177
Provisions for deferred tax		25,304
Equity and reserves		8,636,382
	13,398,863	13,398,863

Profit and loss account	£
Turnover	27,164,856
Other income	2,936
Cost of sales	(19,676,634)
Distribution costs	(285,219)
Administrative expenses	(1,106,176)
Finance costs	(1,375)
Profit before tax	6,098,388
Tax	(1,759,623)
Profit after tax	4,338,765

Impact on prior year profit

Profit after tax as at 30 April 2018 under the entity's previous financial reporting framework amounted to £4,323,065 and under FRS 102 is £4,338,765, giving an increase of £15,700, which is reconciled as follows:

	£
Profit reported under previous framework	4,323,065
Fair value gain on investment property reallocated	20,000
Deferred tax on fair value gain on investment property	(3,400)
Increase in holiday pay provision	(900)
Profit reported under FRS 102	4,338,765

Impact on previously reported equity at 30 April 2018

Previously reported equity amounted to £8,640,682 and under FRS 102 is £8,636,382 giving a difference of £4,300 which is reconciled as follows:

	£
Equity under previous financial reporting framework	8,640,682*
Movement in holiday pay accrual to 30 April 2018	(900)
Deferred tax on fair value gain on investment property at 30 April 2018	(3,400)
Equity under FRS 102	8,636,382

*Per trial balance at 30 April 2018 prepared under previous financial reporting framework:

	£
Share capital	100
Revaluation reserve	20,000
Profit and loss reserves	6,297,517
Profit for the year	4,323,065
	10,640,682
Dividend	(2,000,000)
Equity under previous financial reporting framework	8,640,682

DISCLOSURE REQUIREMENTS

The disclosure requirements in respect of first-time adoption of FRS 102 are outlined in paragraphs 35.12 to 35.15 and are split into two parts: 'explanations' and 'reconciliations'.

Explanations

Paragraph 35.12 requires a reporting entity to explain how the transition from its previous financial reporting framework to FRS 102 has affected its reported financial position and financial performance.

Reconciliations

There are certain reconciliations which must be included in a first-time adopter's financial statements to help users to understand the effect that the transition has had on the entity and must include:

a. a description of the nature of each change in accounting policy;
b. a reconciliation of equity determined in accordance with its previous financial reporting framework to equity determined in accordance with FRS 102 for both of the following dates:
   i the date of transition; and
   ii the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework; and
c. a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with FRS 102 for the same period.

Using the example of Largeco above, the disclosures to comply with the above may look as follows:

Reconciliation of equity	**Note**	**At 1.5.17**	**At 30.4.18**
		£	**£**
Capital and reserves (as previously stated)		6,326,301	8,669,366
Short-term compensated absences	1	(14,200)	(900)
Deferred tax on investment property	2	(14,484)	(3,400)
Capital and reserves (as restated)		6,297,617	8,636,382*

Reconciliation of profit or loss for the year

	Note	Year ended 30.04.2018 £
Profit for the year (as previously reported)		4,323,065
Fair value gain on investment property	2	20,000
Deferred tax on investment property	2	(3,400)
Short-term compensated absences	1	(900)
Profit for the year (as restated)		4,338,765

*For clarity, this figure can be proved as follows:

	£
Capital and reserves per FRS 102 at 1 May 2017	6,297,617
Profit for the year per FRS 102	4,338,765
Dividend paid 30 April 2018	(2,000,000)
Capital and reserves at 30 April 2018	8,636,382

Notes to the reconciliations

Note 1: short-term compensated absences

Prior to applying FRS 102, Largeco Ltd did not make provision for holiday pay (i.e. holiday earned but not taken prior to the year end). FRS 102 requires the cost of short-term compensated absences to be recognised when employees render the service that increases their entitlement. Consequently, an additional accrual of £14,200 at 1 May 2017 has been made to reflect this. The additional provision at 30 April 2018 is £15,100 and the effect on profit for the year ended 30 April 2018 is an additional expense of £900.

Note 2: investment property

The investment property was previously accounted for under the entity's previous financial reporting framework by taking revaluation movements to a revaluation reserve in equity. The property is being measured at fair value under FRS 102, Section 16 and fair value gains and losses are reported in profit or loss. FRS 102 also requires deferred tax to be accounted for on assets which are subject to revaluation. Consequently, additional deferred tax of £14,484 was recognised at 1 May 2017 to reflect the provisions of FRS 102. An additional provision for deferred tax has been recognised at 30 April 2018 amounting to £3,400. The gain on revaluation at 30 April 2018 has been reported in profit or loss and the effect on profit for the year ended 30 April 2018 is an increase in profit of £16,600.

August 2019