The Future of Financial Reporting in the UK and Republic of Ireland

Revised Frequently Asked Questions

Reasons for change

Q	Why is any change to UK financial reporting standards necessary?
A	Just as business evolves and enters into new and differently structured transactions, accounting (and consequently the standards that support it) must evolve. The ASB considers, based on feedback from previous consultations, that current FRSs require a fundamental overhaul. Support for change is evidenced by: (a) Extensive consultation undertaken by the ASB on the future of financial reporting in the UK and Republic of Ireland (RoI). Although views have sometimes been mixed, there is agreement that current FRSs are an uncomfortable mismatch of accounting standards of different origin that lack cohesion or unifying principles. They are a mixture of Statements of Standard Accounting Practice (SSAPs) issued by the Consultative Committee of Accounting Bodies, FRSs developed and issued by the ASB, and IFRS-based standards issued by the ASB to converge with international standards. (b) The need to update financial reporting for financial instruments. Current FRSs permit certain transactions to remain unrecognised that are relevant to the assessment of the financial position of an entity. (c) The programme of activities that took place following the issue of FREDs 43 and 44, which highlighted practical issues associated with maintaining two accounting frameworks. These included the cost associated with training accountants in both IFRS and current FRSs.

Q	What is wrong with current standards?
A	As noted above, accounting standards evolve over time to ensure that an entity's financial statements continue to reflect the substance of the transactions entered into. The ASB, however, has not updated its standards significantly since 2004 when it stopped the phased approach of introducing IFRS-based standards; recognising the IFRS-based standards did not meet the needs of its main constituents now that listed groups applied EU-adopted IFRS. Consequently, standards are now in need of a major overhaul particularly in the area of financial instruments, current FRSs permit certain transactions to remain unrecognised that are relevant to the assessment of the financial position of an entity.

Q	Is the ASB giving up its role and allowing the IASB to become the monopoly standard setter in the UK and Ireland?
	No. The ASB is not surrendering its right to set accounting standards. It remains the body that, under law, currently determines financial reporting requirements in the UK, subject to European Directives. In future, the ASB **will continue to influence high quality global standards**. In addition it will continue to monitor and develop, where necessary, accounting standards for the UK & RoI, namely: (a) **Draft FRS 101**, the reduced disclosure framework permitting qualifying entities to apply the recognition and measurement requirements of EU-adopted IFRS with reduced disclosures; (b) **Draft FRS 102** which will replace current FRSs (including SSAPs and UITF Abstracts). The ASB aims to update the FRS every three years, in line with the IASB's timetable for the IFRS for SMEs. The ASB will consult on each set of proposed changes as part of its deliberations on whether to adopt them into draft FRS 102. There is no compulsion to follow the IASB; (c) **The Financial Reporting Standard for Smaller Entities,** which pending the outcome of the EU decision to change the Accounting Directives will need to be updated; and (d) Facilitating the update statements of recommended practice (SORPs).

Outline of proposals

Q What is the proposed (revised) new framework?

A This diagram may be used to determine the reporting standards to be applied by a particular entity.

The proposed framework (based on proportional financial reporting), which is set out in paragraph 7 of FRED 46, replaces the three-tier system that was previously proposed in FRED 43.

FRSSE	FRS 102	EU-adopted IFRS
Entities eligible for small companies regime	Entities eligible for the small companies regime	Entities eligible for the small companies regime
	Entities not small and not required to apply EU-adopted IFRS	Entities not small and not required to apply EU-adopted IFRS
		Entities required to apply EU-adopted IFRS.

Q	Why did the ASB decide to change the framework and eliminate the definition of public accountability?
A	Whilst many respondents to FRED 43 were supportive of the proposed framework, it was challenged by some of the entities considered to have public accountability. They argued that the costs of reporting under EU-adopted IFRS would outweigh the benefits. In addition, there was concern about the practical application of the definition of public accountability. Although the ASB had provided guidance, respondents sought further clarification. The ASB considered the cost/benefit concerns and undertook analysis to determine whether FRED 44 could be amended to address the needs of entities previously deemed to have public accountability. This analysis identified that: (a) disclosure requirements would need to be expanded for entities seeking to generate wealth from financial instruments; and (b) preparers seeking guidance on areas that were not addressed in FRED 44, such as earnings per share, could refer to EU-adopted IFRS. Consequently, the ASB decided to eliminate the tier system based on public accountability - it could do so only by amending FRED 44. The ASB revised proposals are set out in FRED 47 to 48.

Q	Why has the ASB made so many changes to the IFRS for SMEs why not just adopt it wholesale?
A	In developing FRED 44 the ASB aimed to adopt the IFRS for SMEs wholesale, however, this is not possible because of the requirement to comply with EU law and company law. FRED 44 therefore proposed only minimal changes to the IFRS for SMEs of which most of the changes were purely for compliance with legal requirements. Respondents to FRED 44, on the whole did not support the ASB proposal to make only minimal changes. The following concerns where noted: (a) FRED 44 did not permit certain accounting options that existed in current FRSs and EU-adopted IFRS. Whilst the proposal to simplify accounting standards was welcomed, respondents considered FRED 44 potentially an over-simplification for the UK & RoI. These respondents noted the IFRS for SMEs had been developed by the IASB for countries that had a less developed financial reporting framework than the UK & RoI. (b) removal of the options would reduce comparability between entities that apply EU-adopted IFRS and those

	applying FRED 44 for entities operating in the same market, for example entities applying FRED 44 would not be permitted to revalue of property, plant and equipment whereas entities applying EU-adopted IFRS could revalue; and (c) the removal of the accounting options (such as the inability to include borrowing costs as part of the costs of property, plant and equipment) may cause some entities to breach terms and conditions of current financing arrangements; this gave potential for banks and other lenders to renegotiate existing financing arrangements but at a higher cost of capital. A further view put forward by respondents was that retaining the options that existed in current FRSs would reduce transition costs and ease transition between tiers. As a consequence, the ASB developed revised guidelines for amending the IFRS for SMEs, recognising that if constituents did not support simplification, there was little, if any justification to remove the proposed options.

Impact of Change

Q	What does the ASB believe will be the key benefits to preparers and users of accounts?
A	In the broadest terms, the key benefit to preparers and users is high quality understandable financial reporting proportionate to the size and complexity of an entity and the users' information needs. This improves communication between entities (both for-profit and not-for-profit) and those who provide them with funds, which benefits the whole economy. The draft reduced disclosure framework allows group entities to take advantage of disclosure exemptions in their individual accounts. In particular, it allows entities within listed groups to apply the recognition and measurement requirements of EU-adopted IFRS, giving consistency within groups, whilst reducing disclosure requirements and therefore costs of preparing accounts. For those who will apply draft FRS 102 the ASB expects preparers to benefit from having to look only to one succinct, streamlined book of around 250 pages (current UK standards are almost 10 times the volume). Users will also benefit from this simplification as there will be less scope for confusion over which standards or policy options have been used. The draft standards replace current FRSs using an IFRS framework as their base, using up-to-date accounting language

	consistent with that taught to accountancy students, and reflecting developments in the way businesses operate; in particular with significant improvements in the requirements relating to financial instruments. The revised draft impact assessment discusses the potential benefits in more detail.

Q	How has the ASB quantified the cost of the proposals to be confident that they outweigh the benefits?
A	Any change in accounting requirements leads to some costs of transition. However, the ASB's proportional approach to UK accounting standards means that companies applying the FRSSE will not be affected by these changes. In addition, those companies that do not undertake complex transactions will incur minimal costs. For groups, there will be cost savings as a result of the reduced disclosure framework. The most significant costs of applying the proposed framework are likely to be incurred by entities that have a significant number of complex transactions (particularly financial instruments), but had previously applied neither EU-adopted IFRS, nor FRS 26. The ASB has updated its case studies that demonstrate the impact of the proposals to typical scenarios. Previous feedback to the case studies was positive, with them clearly illustrating the nature of the costs likely to be incurred. Taking into account a variety of factors the ASB continues to believe the total cost of implementing its proposals will be approximately £80million.

Alternatives

Q	What alternative possibilities did the ASB consider?
A	The draft Impact Assessment set out as part of FREDs 46 to 48 outlines the options the ASB has considered during the course of developing the current exposure drafts, further information is available on the ASB website. In developing the proposals the ASB has considered three main options: (a) **Do nothing** – the ASB rejected this option because current FRSs require updating, particularly in the area of financial instruments. Further, the proposals in FRED 47 (reduced disclosures) will bring savings to entities. (b) **UK and Irish accounting standard not based on IFRS** – this option was not supported by respondents to previous consultations. (c) **UK and Irish accounting standards based on IFRS with minimal amendments** – the responses to the October 2010 FREDs suggested respondents were looking for a more tailored approach.

Q	Why was the option of expanding the FRSSE bandwidth not pursued further?
A	When the ASB consulted on this option in 2006, respondents had mixed views and did not generally support it. The main concern (also raised by the ASB's Committee on Accounting for Smaller Entities) was that the FRSSE in its current form is not suitable for medium-sized or large entities. Two main courses of action seemed possible: (a) First, the FRSSE could be left unchanged, including its requirement to look to other standards for transactions not covered in the FRSSE – but this is impracticable within a proposal to remove the body of UK standards (it would be inefficient to maintain a full body of standards simply as a fall-back position); or (b) The FRSSE could be modified to cover areas where it at present has no or very little guidance (for instance, financial instruments, business combinations, debt/equity classification) and areas where the guidance it contains is inappropriate for larger entities (for instance, where at present share-based payments are dealt with through disclosure only). Since the first option would be inefficient and the second would modify the FRSSE to an extent that would make it no

	longer suited to small entities, the ASB decided not to pursue this further. The responses to FRED 44 did not indicate any further desire to increase the scope of the FRSSE. If the EU proposals for small and micro companies become effective it would not be possible to expand the bandwidth as such entities would have a maximum disclosure regime.

Timing of change

Q	When would the proposals take effect?
A	The proposed effective date is accounting periods beginning on or after 1 January 2015, so for entities with 12-month accounting periods, the first to apply the new framework would be those with 31 December 2015 year ends. Early adoption is permitted.

Q	Why are the changes being made now?
A	The ASB has been consulting on the future of UK financial reporting since 2004. It considers that the time is right to move forward on convergence for reasons including: (a) quoted companies (and their auditors and users) now have several years of experience in EU-adopted IFRS; (b) the IASB has issued the IFRS for SMEs, which is much simpler than EU-adopted IFRS and so it gave the ASB a key building block in its financial reporting strategy; and (c) UK accounting standards are becoming increasingly out of date, for instance in not requiring recognition of certain financial instruments, such as interest rate swaps, whose use has become widespread.

Entities affected

Q	Which types of entity will this affect?
A	The proposals apply to all entities that prepare financial statements that are intended to give a true and fair view; they are applicable to public benefit entities (also known as not-for-profit entities) and other entities, not just to companies. The requirements encompass all entities that are currently required to apply UK GAAP, but entities applying the FRSSE will not be required to make adjustments to their existing accounting policies as only consequential amendments are proposed to the FRSSE.

Q	Will any more entities be required to use EU-adopted IFRS than currently do?
A	No – this is an area of change since FRED 43 and 44. The revised proposals do not extend the application of EU-adopted IFRS beyond the requirements of the EU's IAS Regulation. An entity will only be required to apply EU-adopted IFRS if required to do so by the IAS Regulation (or other existing legislation or regulation, if applicable).

Q	Who can apply the proposals in FRED 47?
A	FRED 47 proposals can be applied by a qualifying entity, which is defined as "a member of a group that prepares publicly available financial statements, which give a true and fair view, in which that member is consolidated". The phrase "member of a group" encompasses both subsidiaries (including intermediate parents) and ultimate parents.

Q	If I am a qualifying entity then do I have to comply with all EU-adopted IFRS disclosures?
A	No – You can take advantage of disclosure exemptions (a reduced disclosure framework) set out in FRED 47, but you must apply the recognition, measurement and disclosure requirements of EU-adopted IFRS. Alternatively, you can apply FRED 48 proposals, which also sets out disclosure exemptions for qualifying entities.

Q	What about entities using the FRSSE?
A	The conditions for eligibility for the FRSSE have not changed, so entities that currently use the FRSSE will still be able to use it afterwards (unless their circumstances have changed). Entities eligible to use the FRSSE but which previously chose to use full UK GAAP will be able to report under either the FRSSE or draft FRS 102.

Q	So will the FRSSE remain in place indefinitely?
A	The ASB is leaving the FRSSE in place for now, to minimise disruption to small entities. However, there will be implications for the FRSSE from the European Commission proposals on its review of the EU Accounting Directives issued in October 2011, and currently intended to be effective by 1 July 2014. The ASB decided that the FRSSE should be retained, but that the existing FRSSE (effective April 2008) will require significant revision to maintain consistency with company law, once it has been revised. This will also provide an opportunity to update it for consistency with draft FRS 102, where relevant. The ASB will consult on the options for the revision of the FRSSE, including the extent to which consistency with draft FRS 102 should be achieved, once changes to the Directives are clear; this is expected to be during the first half of 2012.

Q	What about "micro entities"?
A	The EU has voted to give Member States an option of exempting micro entities (essentially those with fewer than 10 employees and turnover below €700k) from certain financial reporting requirements. It will be considered as part of the review and implementation of the revised Accounting Directives more generally.

Q	How are public benefit entities affected by the proposals?
A	We believe that in practice the proposals in FRED 48 will not significantly affect PBEs. That said, the major changes we envisage will be for: (a) those PBEs that hold financial instruments that were not previously required to be recognised will now have to do so; (b) grants will no longer be allowed to be offset against the asset for which it was received; and (c) PBEs that receive or make below market loans will have the option to recognise those loans at the amount received or paid (less any applicable interest and or impairment loss) rather than using the financial instrument requirements in draft FRS 102. When Financial Reporting Exposure Draft 45 'Financial Reporting for Public Benefit Entities' was exposed in March 2011, it was proposed that donations (including goods and services) should be recognised as income when they were received. This proposal was greatly opposed, so the proposals in this FRED have been amended to emphasise that this requirement only applies when such donations are material, can be measured reliably and when the benefits of recognising them outweigh the cost.

Specific concerns

Q	Has the ASB considered the risk that, because draft FRS 102 is not identical to EU-adopted IFRS, this will make it more difficult for a UK private company to list in the future?
A	The ASB's aim is to promote high quality financial reporting. The introduction of the proposals in FRED 46 to 48 will move the UK & RoI to a framework that is based on international standards. As part of its revision to FRED 44 (now FRED 48) the ASB has introduced accounting options that are permitted in accordance with EU-adopted IFRS. The proposals in FRED 44 are therefore more closely aligned with EU-adopted IFRS than its previous proposals. In addition, entities have the option to apply EU-adopted IFRS, so if a company's management is considering listing in the future, it can apply this option. Consequently, in the ASB's view, listing will be no harder under the new framework than under the existing framework.

Outreach

Q	What is the ASB doing to ensure that the people affected by these proposed changes know enough about them?
A	Following the publication of FRED 43 and 44, the ASB undertook an outreach programme to elicit views and encourage debate. The ASB has sought to consider the views expressed by respondents to FRED 43 and 44 and amend its proposals where appropriate. The ASB in conjunction with the accounting profession will continue to present and hold meetings on the revised proposals. It is crucial that all views are heard, so the ASB encourages everyone with an interest to respond to the FRED, whether in support or disagreement, on specific points or with more general suggestions about the direction of the project. All responses are considered seriously and are taken into account in the decision whether to issue a final standard, and what modifications may be needed. The deadline for comment is 30 April 2012.

Q	What are the main differences between current FRSs and draft FRS 102?
A	Draft FRS 102 uses an IFRS-based framework, which is set out in Section 2 'Concepts and pervasive principles'. This replaces the ASB's Statement of Principles, although much of it is similar. Following the ASB decision to amend the IFRS for SMEs further as part of its revised proposals, there are fewer differences between current FRSs and draft FRS 102. The precise differences will vary, depending on the entity, however the most significant change is likely to be related to financial instruments. Draft FRS 102 defines "basic financial instruments" (such as simple bank loans, trade receivables and payables) and requires that these are held at amortised cost; financial instruments not in this category (such as forward foreign currency contracts or interest rate swaps) must be held at fair value. This will give rise to some financial instruments being recognised in the balance sheet that were not required to be recognised in accordance with current FRS.

Q	What does the ASB mean when it refers to the draft FRS 102 as giving 'simplified accounting'?
A	While preparers may still need to make a number of accounting adjustments, the ASB believes that transition to draft FRS 102 will be simpler and that the succinct nature of draft FRS 102 will be easier to apply in the longer term. One clear advantage is that of sheer volume: draft FRS 102 runs to approximately 250 pages, compared with current UK standards, which are something over 2,000 pages. Draft FRS 102 is also sorted by subject area, which makes it easier for anyone reading or preparing accounts to be confident that they have found the relevant requirements. An example is revenue: preparers applying draft FRS 102 will look only to Section 23, whereas depending on the industry and type of transaction, a preparer under current FRSs needed to refer to FRS 5 Application Note G, SSAP 9, UITF 26 and UITF 40.

Q	What are the arrangements for transition to draft FRS 102? Are any exemptions available?
A	Entities applying draft FRS 102 for the first time will need to restate their balance sheets for the beginning and end of the comparative period. For instance, an entity with a December 2015 year end applying draft FRS 102 for the first time would have a 'transition date' of 1 January 2014, which is the date used for restating balances in accordance with the new policies. Section 35 of draft FRS 102 includes a number of exemptions on transition – for example an entity is not required to recalculate goodwill for acquisition before the transition date.

Q	The ASB has revised the requirements for the presumed useful life for goodwill. Does this mean that preparers will need to revisit the accounting for their existing goodwill?
A	FRED 48 provides that goodwill should be amortised on a systematic basis over its life. If an entity is unable to make a reliable estimate of the useful, the life shall be presumed to be 5 years. Entities with existing goodwill that has a useful economic life longer than 5 years will therefore not need to amend their existing accounting for goodwill, providing there is evidence of the remaining economic life.

Q	What effect would adopting draft FRS 102 have on tax and distributable profits?
A	This will depend on the nature and complexity of an entity's transactions. HMRC is examining the details in order to be able to understand, and communicate about the potential effects on taxable profits. Distributable profits is a complex area where accounting standards and company law interface. A useful source of guidance is Tech 01/09 "Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006", which was issued jointly by the ICAEW and ICAS. In addition FRS 17 'Retirement Benefits' recognises that that many group schemes are run on a basis that does not enable individual companies within the group to identify their share of the underlying assets and liabilities. It therefore permits individual companies (including the parent company) within the group to account for the scheme as a defined

	contribution scheme. In contrast, paragraph 28.38 of draft FRS 102 requires group plans to be accounted for as a defined benefit plan. If there is a contractual agreement or stated policy for charging the cost of a defined benefit plan as a whole measured in accordance with the proposals in draft FRS 102 to individual group entities this cost can be recognised. If there is no such an agreement then the sponsoring employer recognises the full cost.