

New UK GAAP – FRS 102

Impact and Key Differences



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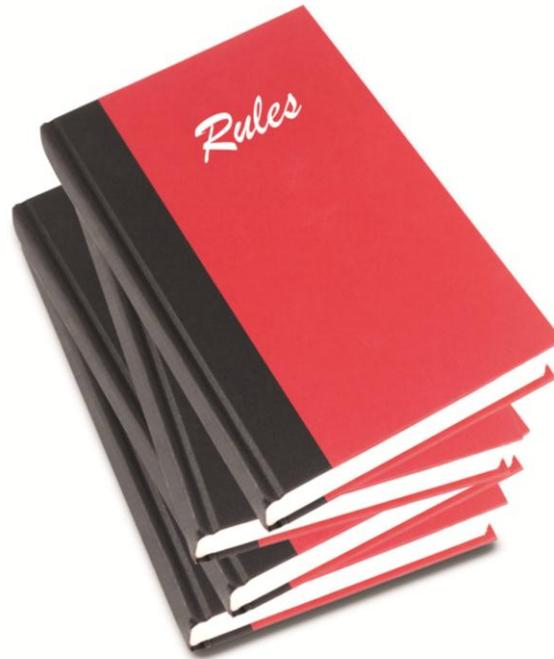
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1 Background

- Financial Reporting Standard ('FRS') 100 'Application of Financial Reporting Requirements' and FRS 101 'Reduced Disclosure Framework' were issued in November 2012 with the main standard FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' issued in March 2013.
- As we move towards practical implementation of these standards, there are continual updates and refinements to these standards.
- FRS 100 deals with the overall application of the new Standards and confirms the approach as follows:
 - Companies required to adopt EU-adopted International Financial Reporting Standards ('IFRS') (e.g. listed entities) must continue to adopt EU-adopted IFRS.
 - Subsidiaries of such companies will be able to take advantage of certain disclosure exemptions, and these are the subject of FRS 101.
 - Companies qualifying as small under the Companies Act 2006 can continue to use the Financial Reporting Standard for Smaller Entities ('FRSSE').
 - All other companies will adopt FRS 102. This is a single Financial Reporting Standard that replaces all of the existing SSAPs, FRSs and UITFs in force, and is split into 35 Sections.
- As regards companies which qualify as small under the Companies Act 2006:
 - They are able to continue to prepare their financial statements under the FRSSE. The FRSSE (effective January 2015) updated the FRSSE (effective April 2008) for certain small changes that had been incorporated within FRS 102, and applies for accounting periods commencing on or after 1 January 2015.
 - However, due to legislative changes introduced in the UK by the EU Accounting Directive, the FRSSE (effective January 2015) will be inconsistent with the requirements of UK company legislation for accounting periods commencing on or after 1 January 2016. Consequently, in July 2015 Section 1A *Small Entities* was introduced into FRS 102. This new section is effective for accounting periods commencing on or after 1 January 2016 with an option to apply for accounting periods commencing on or after 1 January 2015. The early application is permitted only if the changes to UK company legislation are adopted early.

- In effect, the FRSSE (effective January 2015) only has a shelf life of one year before being replaced by FRS 102 Section 1A *Small Entities*.
- Under FRS 102 Section 1A *Small Entities* small entities will apply the recognition and measurement requirements of FRS 102, but presentation and disclosure requirements based on company law, thus ensuring that all entities reporting under new UK GAAP apply a consistent framework.



2 FRS 102

- FRS 102 will become the Standard for accounting for unlisted medium-sized and large entities in the UK. It has been through several consultations and was originally based on the 'IFRS for SMEs' drawn up in the EU. During those consultations, the Standard evolved into a version of the 'IFRS for SMEs' that was amended for various treatments that were extant under existing UK GAAP. As a result, the final FRS 102 is much closer to existing UK GAAP than the 'IFRS for SMEs'. In fact, for some companies, the impact of adopting FRS 102 will be minimal, except for the increased level of disclosure.
- FRS 102 will first apply to accounting periods commencing on or after 1 January 2015. This means that the first financial statements to be affected will generally be 31 December 2015 year ends. The comparatives will also be restated meaning the opening balance sheet at 1 January 2014 (i.e. 31 December 2013) will have to be restated. Section 35 of FRS 102 deals with the transition from existing UK GAAP and contains various exemptions from retrospective application.
- Early adoption of FRS 102 is however permitted for accounting periods ending on or after 31 December 2012.

3 What does FRS 102 mean for you?

- The change in accounting framework is possibly one of the single largest changes to affect UK accounting over the past 20 years and should not be underestimated.
- As directors, you need to understand the implications of this change, take advice from your auditors on the changes (in particular the ones that will affect you significantly) and plan ahead to ensure all information is available when the first set of FRS 102 financial statements have to be prepared. This may necessitate changes to systems to capture required accounting information.
- This guide takes you through key identified areas that will impact many companies and that you need to be aware of, together with notes of practical considerations and an impact checklist, the latter contained in the 'FRS 102 impact checklist' section.
- Many accounts these days are prepared using accounts production software, which will assist to some degree when the first set of FRS 102 financial statements is prepared. The hard work has to be done in the background, in conjunction with your auditors. There will also be extensive disclosure changes. Accounts production software will be being updated ready for the anticipated first year application of FRS 102, but may not be ready if you want to early adopt.
- The relevant dates for FRS 102 have already been highlighted - remember a 31 December 2015 year end has a transition date of 1 January 2014. Information needed for converting the balance sheet at 31 December 2013 to FRS 102 must be considered now.
- Conversion to FRS 102 will have cost implications for both you and your auditors.
- How long will it take to deal with the first set of FRS 102 financial statements? This is a key question and will depend on the complexity of your company, mainly in terms of conversion issues.
- You will need the support of your auditors to deal with your queries on conversion to FRS 102.

- You will also need to establish the level of additional costs that your auditors will charge for assisting with the conversion, auditing conversion matters and where they prepare the financial statements, the additional costs for those financial statements.
- The overall message here is plan ahead, with the assistance of your auditors, to ensure that conversion can be undertaken as efficiently as possible for all parties concerned.



Key Differences



4 Financial Statements

The format of the primary financial statements is still governed by the Companies Act 2006, but there are some changes:

Revised format	Current format	Changes
Income statement	Profit and loss account	No significant changes.
Statement of comprehensive income	Statement of total recognised gains & losses	No significant changes.
Statement of cash flows	Cash flow statement	The statement of cash flows uses the concept of “cash and cash equivalents” rather than merely “cash”.
Statement of financial position	Balance sheet	No significant changes.
Statement of changes in equity	No current primary statement	Currently dealt with as a note to the financial statements “Reconciliation of movement in shareholders’ funds”. Essentially this note is being brought into the primary financial statements.

There are however the following presentational options:

- A single “Statement of comprehensive income” can be presented, combining the “Income statement” and the “Statement of comprehensive income”.
- A “Statement of Income and Retained Earnings” can be presented which in essence merges the “Income statement”, the “Statement of comprehensive income” and the “Statement of changes in equity” into one statement. This can only be done however, if the only changes in equity in the year are the profit or loss, payment of dividends, correction of prior period material errors and the effects of changes in accounting policy.

Whilst FRS 102 specifies the titles of the primary financial statements, it does allow other titles to be used so long as they are not misleading. Many companies may therefore wish to retain the existing terminology of “Profit and loss account” and “Balance sheet”.

Your auditors will be able to advise you on the primary financial statement presentation that suits your requirements.

5 Loans which carry no interest, or is below market rates

Existing UK GAAP	FRS 102	Impact
<ul style="list-style-type: none"> Carried on balance sheet at the loan amount less capital repayments. Interest (where the loan carries interest) is charged through the profit and loss account on an accruals basis. Interest is not recognised on loans that do not carry interest. 	<ul style="list-style-type: none"> Recognised on balance sheet by discounting the expected cash flows using a market rate of interest. Subsequently recognised on balance sheet taking account of actual cash flows (interest and repayments) using the amortised cost method, using the market rate of interest to calculate the annual interest charge to be reflected in the profit and loss. 	<ul style="list-style-type: none"> Loans that carry no interest, received by a company, will be recorded at a discounted value lower than under existing UK GAAP. The difference will be recorded as interest income when the loan is made, with an interest expense in subsequent years. This reflects the company having the benefit of an interest free arrangement. Loans that carry interest below market rates will have similar considerations as those that carry no interest. Market rates of interest for many significant unsecured loans will need to be established. Impacts on loans between group companies many of which can be interest free. In parent and subsidiary relationships, these may need to be treated as a capital contribution by the parent (as part of their cost of the investment) and a capital reserve in the subsidiary to reflect the benefit of the loan received.

Practical considerations:

- Identify, firstly, if you do have such loans or not, who they are with and their terms.
- Although you may have bank loans that you think are at a market rate, did your bank give you a preferential loan rate when you took them out? In a group situation are there interest free loans between group companies? If these apply, these also fall into this equation.
- If you don't, again you can merely move on.
- You will need to determine appropriate market rates of interest for these loans. This might prove difficult for an unsecured, interest free loan of £300,000 with a three year repayment, and will likely necessitate obtaining details either from the market place or from your bankers.
- Again consult with your auditors and they will be able to advise accordingly.
- An example on the accounting for an interest free loan under FRS 102 is contained within the 'Practical examples' section.

6 Valuation of property used in the business

Existing UK GAAP	FRS 102	Impact
<ul style="list-style-type: none"> Property can be revalued. Once into the revaluation model, full revaluations required every 5 years with an interim valuation in year 3. No requirement to provide deferred tax unless binding sale agreement in place at year end. Separate revaluation reserve is required. 	<ul style="list-style-type: none"> Property can be revalued. Once into the valuation model, valuations required at sufficient frequency to ensure that carrying value is not materially different to fair value. Deferred tax must be provided on the revaluation. Separate revaluation reserve is not required but is an option. 	<ul style="list-style-type: none"> For audited entities choosing to revalue, an annual valuation of some description is likely to be necessary. Provision for deferred tax will reduce the upward impact of the valuation on net assets. Valuation gains and related deferred tax have no impact on distributable reserves as these are 'unrealised' under the Companies Act. Impairment charges to the profit and loss account, arising from a valuation, however will impact distributable reserves as these are considered to be 'realised' under the Companies Act. With no separate revaluation reserve, it may be appropriate to maintain memoranda records of distributable and non-distributable reserves.

Practical considerations:

- Do you have property or other tangible fixed assets carried at a valuation?
- If you don't, do not move on as there is an important opportunity here for you.
- You may have property that was acquired a number of years ago sat on your balance sheet at £100,000, but is actually worth £5m. FRS 102 does allow you to have a final 'deathbed' valuation at transition date. If you wished to increase your company's net asset base, this approach could work for you, although you would likely incur the cost of a valuer. This can also work for plant and machinery, although any valuation has to apply to the whole class of plant and machinery, as it also would do for property classes.
- FRS 102 allows the final 'deathbed' valuation, or a previous GAAP valuation, to be regarded as deemed cost, thereby meaning you do not have to apply a policy of revaluation going forward.
- If you wish to continue with a revaluation policy, this has to apply to all assets within the class (no 'cherry picking') and might prove expensive - the valuation needs are linked to changes in fair values. Fair values of property may be more volatile and require more frequent valuations, unlike fair values for plant and machinery which may be more stable over a long period of time.

- The downside to any revaluation, either before or after FRS 102 applies, is that FRS 102 requires a deferred tax provision to reflect the capital gain on revalued assets as if there were to be 'sold' at the year end. The cost history on property or plant may not always be available. For old properties it may need a March 1982 valuation to identify the correct base cost for the calculation of the capital gain, or alternatively use insurance reinstatement values around March 1982 if you have retained these.
- Again your auditors/taxation advisors will be able to help you.



7 Investment property

Existing UK GAAP	FRS 102	Impact
<ul style="list-style-type: none"> Must be held in the balance sheet at market value, implying that an annual valuation is required. Movements in the valuation are put to a revaluation reserve. No requirement to provide deferred tax unless binding sale agreement in place at year end. Does not allow properties occupied by other group companies to be treated as such. Separate revaluation reserve is required. 	<ul style="list-style-type: none"> Must be held in the balance sheet at fair value, again implying an annual valuation is required. Movements in the valuation go through profit and loss. Deferred tax must be provided on the revaluation and is charged to the profit and loss account. Includes investment properties occupied by other group companies (although these will not be investments properties in group financial statements) Separate revaluation reserve is not required but is an option. 	<ul style="list-style-type: none"> Potential volatility in reported profits arising from movements in investment property valuations. Provision for deferred tax will reduce the upward impact of the valuation on net assets. Valuation gains and related deferred tax have no impact on distributable reserves as these are 'unrealised' under the Companies Act. Valuation losses will similarly be 'unrealised'. With no separate revaluation reserve it may be appropriate to maintain memoranda records of distributable and non-distributable reserves.

Practical considerations:

- Identify if you have investment properties.
- Be careful as you might have more than you think! For example, in a group situation property owned by one company but used by another group company is an investment property for FRS 102 purposes, although this drops out on a group consolidation.
- The annual valuation requirement may prove expensive for you. You may be able to negotiate terms with valuers for on-going valuations which could reduce the cost impact.
- Deferred tax will require the calculation of the capital gain on property as if it was 'sold' at the year end. The cost history on property may not always be available. For old properties it may be necessary to obtain a March 1982 valuation to identify the correct base cost for the calculation of the capital gain, or alternatively use insurance reinstatement values around March 1982 if you have retained these.
- Again speak to your auditors/taxation advisors and they will be able to help you.

8 Derivatives and hedging

Existing UK GAAP	FRS 102	Impact
<ul style="list-style-type: none"> ■ No requirement to include derivatives (e.g. interest rate swaps, forward exchange contracts) on the balance sheet. ■ Hedged items can be translated at the contracted rate if identifiable. ■ 'Hedge accounting' is an option under the Companies Act 2006 for fair value accounting which allows some or all of the fair value changes in a hedging instrument to be recorded as a reserves movement rather than a profit and loss item. ■ 'Hedge accounting' is required to be documented and the hedging relationship must be expected to be highly effective. 	<ul style="list-style-type: none"> ■ Derivatives are treated as separate instruments and included on the balance sheet at their fair value whether that is an asset or liability. ■ 'Hedge accounting' is a voluntary option, but can only be applied if 5 conditions are met including documenting the hedging relationship and causes of inefficiency. ■ 'Hedge accounting' is only permitted for hedging relationships including fair value hedges and cash flow hedges. 	<ul style="list-style-type: none"> ■ Fair value will need to be obtained for derivatives, which will require assistance from the issuer (e.g. a bank). Movement on fair value goes through profit and loss unless 'hedge accounting' is permitted and applied. ■ Formal documentation is needed to apply 'hedge accounting'. ■ 'Hedge accounting' with a cash flow hedge permits the portion of the change in fair value of the effective hedge to be recorded as a reserves movement in 'other comprehensive income', with the ineffective element being recorded in profit and loss.

Practical considerations:

- Identify, firstly, if you have any of these instruments (e.g. interest rate swaps, forward exchange contracts).
- If you don't have any, you can move on.
- If you do, then you need to consider how to obtain the fair values. Many of these instruments are issued by banks and so you can request a valuation from them. Also liaise with your auditors, as they send year end bank confirmation requests which can be used to request derivative information and fair values.
- Do you wish to apply the option for 'hedge accounting' and if so are you able to meet the criteria?
- Do existing systems need to be modified for 'hedge accounting' and does documentation need to be put in place for the hedging relationship and ineffectiveness?
- For a company with a 31 December 2013 year end, this is the first balance sheet that will need to be converted to FRS 102 for the 31 December 2015 year end financial statements. Fair values of such instruments, in this case, are needed at 31 December 2013 and at every succeeding year end.

- An example on the accounting differences between SSAP 20 and FRS 102 on a forward exchange contract, including the derivative accounting, is contained within the 'Practical examples' section.

Gain/Loss	Value at 21.03.2004	Distributions & Rebates	Gross Return
176		7	92.14%
221	2,247	0	41.91%
51	5,721	0	18.96%
248	2,800	0	47.03%
338	5,748	11	111.37%
51	3,585	0	50.13%
64	1,112	7	35.27%
37	2,163	12	24.64%
	2,154	63	105.42%
	1,102	4	-1.95%
	1,062	11	-32.99%
	3,019	34	50.09%
	2,126	11	58.43%
	3,268	160	44.99%
	1,107		
9		0	39.33%
		0	23.98%
		0	57.74%
		0	39.63%
		0	38.11%

9 Listed investments

Existing UK GAAP	FRS 102	Impact
<ul style="list-style-type: none">▪ Can be held in the balance sheet at historic cost or valuation.▪ If the valuation model is followed, other similar items must be included at valuation.	<ul style="list-style-type: none">▪ Must be held in the balance sheet at fair value, based on stock exchange prices.▪ Movements in the valuation go through profit and loss.	<ul style="list-style-type: none">▪ Potential volatility in reported profits arising from movements in investment valuations.▪ Gains and losses on listed investments including any related deferred tax will impact on distributable reserves as these are 'realised' under the Companies Act.

Practical considerations:

- Information should be readily available from the market and should not pose any issues.

10 Acquisition accounting and intangibles

Existing UK GAAP	FRS 102	Impact
<ul style="list-style-type: none"> ▪ Identifiable assets and liabilities are assessed for their fair value. ▪ The difference between this fair value and consideration is classified as goodwill. ▪ Goodwill can be deemed to have a long or indefinite life, but annual impairment review required if more than 20 years or indefinite. ▪ Deferred tax is not recognised on acquisitions. 	<ul style="list-style-type: none"> ▪ Identifiable assets and liabilities are assessed for fair value, but this could include various types of intangible asset. ▪ The difference between this fair value and consideration is classified as goodwill. ▪ Goodwill and intangibles must be amortised, with a life of no longer than 10 years if a reliable estimate cannot be made (in July 2015 this was changed from 5 years to 10 years). ▪ Deferred tax must be recognised on the difference between fair values of identifiable assets and liabilities and the amount assessed for tax. 	<ul style="list-style-type: none"> ▪ Companies that previously chose not to amortise goodwill will have to do so, and will have a new charge in profit and loss. ▪ Acquiring companies will be recognising intangibles that were not previously recognised on acquisition (e.g. brands) and amortise these also. ▪ Companies will need to do more to justify the life of intangibles and goodwill or face a high rate of amortisation. ▪ Additional deferred tax provisions/assets will be required on acquisitions – goodwill is adjusted by the amount of the deferred tax recognised.

Practical considerations:

- If you are acquisitive by nature then you need to consider this very carefully.
- The requirement concerning valuation of intangibles will apply from the transition date. For a 31 December 2015 year end, the transition date, assuming no change of year ends, is 1 January 2014. For every acquisition on or after transition date intangibles valuations are likely. This applies even though the financial statements for the year ended 31 December 2014 will be prepared under existing UK GAAP.
- On transition there is the option to go back and re-state acquisitions before transition to comply with FRS 102. If you wanted to do this you need to be aware that you would have to restate all acquisitions since the earliest one you have opted to restate. These would necessitate intangibles valuations.
- Your auditors will be able to advise on this but will likely be barred by Ethical Standards from performing those intangibles valuations for you.

- You may need to obtain independent intangibles valuations, which could be expensive, and also your auditors will have to audit those valuations.
- If goodwill amortisation is deductible for corporation tax purposes, there may be a potential corporation tax opportunity for you. If there is no reliable estimate of the useful life of goodwill and 20 years under FRS 10 has been used, you will need to change your amortisation period to the default useful life of not more than 10 years. This will accelerate the corporation tax relief you obtain on deductible amortisation. The potential benefit of this does however need to be matched up if you are on a dividend policy rather than remuneration, as distributable reserves would be diminished.
- Consult with your auditors/taxation advisers to see if this could have benefit for you.

11 Defined benefit pension obligations

Existing UK GAAP	FRS 102	Impact
<ul style="list-style-type: none"> ▪ The measurement of the net finance cost under FRS 17 is derived from the yield on scheme assets less the discount rate applied to scheme liabilities. ▪ The yield on scheme assets is typically lower than the discount rate on scheme liabilities. 	<ul style="list-style-type: none"> ▪ The finance cost is derived by applying the discount rate to the net scheme liabilities. ▪ No separate consideration is given to the yield on scheme assets in determining the finance cost. 	<ul style="list-style-type: none"> ▪ For schemes with pension deficits the finance cost charge to the profit and loss account will increase.

Practical considerations:

- If you do not have one of these, move on.
- If you do, you will need to have FRS 102 actuarial valuations running concurrently with FRS 17 actuarial valuations up to your last pre-FRS 102 set of financial statements.
- For a 31 December 2015 year end, the transition date, assuming no change of year end, is 1 January 2014. FRS 102 actuarial valuations, as well as FRS 17 actuarial valuations, will be needed at 31 December 2013 & 31 December 2014. Thereafter only FRS 102 actuarial valuations are needed.

12 Holiday pay accruals

Existing UK GAAP	FRS 102	Impact
<ul style="list-style-type: none">No explicit requirements.	<ul style="list-style-type: none">Accrual required at the balance sheet date for pro rate holiday not taken at that point.	<ul style="list-style-type: none">Accruals and charges to profit and loss compared to the current position.

Practical considerations:

- Does your holiday year align with your accounting year?
- If so no significant impact is expected, unless you allow holiday to be carried forward.
- If not, you may consider whether or not to do so, although aligning would no doubt have a Human Resources affect.
- If you do not align, unused holiday entitlements at the end of the financial year will need to be compiled by your Human Resources departments, to enable the accrual calculations to be done. Are there systems in place to capture this information readily?
- If holiday pay lapses when an employee leaves and no cash payment is made, the calculation of the accrual involves establishing estimates for the average unused holiday entitlement per employee and the percentage of employees who leave having never taken their unused holiday entitlement.

13 Other considerations

- As highlighted above, financial performance under FRS 102 will be reported differently than under existing UK GAAP.
- It is important if you have contractual profit-based bonus schemes that you review the arrangements to ensure that any changes under FRS 102 are taken into account. The same will apply to similar issues such as earn out periods that span the transition date.
- The extent of this effect on financial performance will vary from company to company but the impact on loan covenants should not be underestimated. Volatility in earnings may well impact on covenants and you need to be reviewing your loan covenants to ensure that these will still be met under FRS 102.
- With all these areas, your auditors/taxation advisers will be able to provide you with guidance and advice - you should seek this at your earliest opportunity.
- A useful checklist, to assist you with identifying the key impact of FRS 102 on you, is contained in the 'FRS 102 impact checklist' section.

14 FRS 102 impact checklist

This checklist enables you to consider the key impact on you of FRS 102, to take forward and discuss with your auditors and/or taxation advisors.

	Yes	No
Do we have any loans that carry no interest or have preferential rates of interest?		
Do we have high amounts of directors'/shareholder/group funding, with or without formal agreements, which could be caught under this?		
Do we have property or other tangible fixed assets included at a valuation?		
Is our property or plant worth much more than it is held on the balance sheet? Could we revalue at transition to increase our net asset value, weighing up the need for valuation costs and the need for a deferred tax provision?		
Do we have the historical data for property capital gains tax calculations?		
Do we have any investment properties?		
Do we have any property that is let to another group company that will be classed as an investment property?		
Do we have the historical data for investment property capital gains tax calculations?		
Do we have any of the following derivatives: interest rate swaps, forward exchange or commodity contracts?		
Is 'hedge accounting' an option for us and do we have systems in place to meet the criteria?		
Do we intend to make business acquisitions after our transition date?		
Do we need to consider whether we wish to restate any business acquisitions before our transition date and consider the other intangibles acquired at that time?		
If we need an intangibles valuation, who do we instruct to do this?		
Have we goodwill that has no reliable useful economic life?		
Is there a corporation tax benefit of a shorter useful economic life if goodwill amortisation is deductible?		
Do we have a defined benefit pension scheme?		
Do we need concurrent FRS 102 valuations as well as FRS 17 valuations from the actuary?		
Does our holiday pay year align with our year end?		
Do we have all information easily available to calculate a holiday pay accrual at our year end?		
Do systems need to be modified to capture all required information?		

15 Contact

If you would like to find out more information on how FRS 102 will affect you, please speak to your usual Hazlewoods contact or alternatively one of our dedicated FRS 102 team:

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Practical Examples



16 Practical Example: Loan with no interest

Example:

A director lends a company £100,000 to a company at its balance sheet date. It is unsecured, interest free and repayable in full in three years time. The market rate of interest for such a loan is established to be 10%.

Initial recognition of the loan

The loan is recognised initially by discounting the expected cash outflows arising from the loan. In this case the £100,000 repayment is discounted by 10% (the market rate) for three years which amounts to £75,131. The journal entries required are:

1. Dr Cash £100,000

Cr Loan £75,131

Cr Finance income £24,869

FRS 102 is effectively saying you must reflect in the company's performance the benefit of obtaining the interest free loan.

Interest charge in year 1

The interest charge is derived from applying the market rate of interest to the carrying value of the loan. In this case the carrying value of the loan is £75,131 and the interest charge at 10% is therefore £7,513. The journal entries are:

2. Dr Interest charge £7,513

Cr Loan £7,513

Interest charge in year 2

The carrying value of the loan by virtue of journal 2 above is now £82,644. The interest charge for year 2 on the carrying value of the loan at 10% is therefore £8,264. The journal entries are:

17 Practical Example: Forward currency contracts

Example:

A UK entity sells goods to a US customer on 1 November 201X. The invoice is for \$100,000 for settlement in 3 months i.e. 31 January 201Y. On 1 November 201X, the entity enters into a forward contract to sell \$100,000 on 31 January 201Y at a contracted rate of 1.62. The entity has a 31 December year:

Details of GBP/USD exchange rates are below:

- Spot rate at 1 November 201X = 1.6
- Spot rate at 31 December 201X = 1.57
- Spot rate at 31 January 201Y = 1.55
- Forward rate to 31 January 201Y at 1 November 201X = 1.62
- Forward rate to 31 January 201Y at 31 December 201X = 1.59

Option 1 (under SSAP 20)

This shows the accounting entries if the entity chooses to use the exchange rate specified in the forward contract as permitted by SSAP 20.4.

At 1 November 201X - transaction date

1. Dr Debtors £61,728 (\$100,000 at the contracted rate 1.62)

Cr Sales £61,728

At 31 December 201X - year end

No accounting entries required as SSAP 20 permits foreign currency monetary assets to be measured at the contracted rate.

At 31 January 201Y - settlement date

2. Dr Cash £61,728
 Cr Debtors £61,728

Option 2 (under SSAP 20)

This shows the accounting entries if the entity uses the spot rate on the transaction date.

At 1 November 201X - transaction date

1. Dr Debtors £62,500 (\$100,000 at the exchange rate at transaction date 1.6)
 Cr Sales £62,500

At 31 December 201X - year end (re-measurement at the balance sheet date)

2. Dr Debtors £1,1943 (\$100,000 at exchange rate at balance sheet date 1.57 (£63,694) less £62,500)
 Cr FX gain £1,194

At 31 January 201Y - settlement date (re-measurement at the settlement date)

3. Dr Debtors £822 (\$100,000 at the exchange rate at settlement date 1.55 (£64,516) less £63,694)
 Cr FX gain £822

On debtor settlement

4. Dr Cash £61,728 (\$100,000 at the contracted rate 1.62)
 Dr Loss on derivative £2,788
 Cr Debtors £64,516

Under FRS102

The accounting entries for the debtor will be the same as for Option 2 (entries 1-3 above). However, there will be additional entries for recognition and measurement of the derivative.

At 1 November 201X - transaction date

At the transaction date the forward contract will have a fair value of zero.

At 31 December 201X - year end (derivative at fair value)

1. Dr Loss on derivative £1,165

Cr Derivative liability £1,165

Difference between \$100,000 at contracted rate 1.62 (£61,728) and forward rate at year end 1.59 (£62,893)

Derivative - fair value change at settlement date

2. Dr Loss on derivative £1,623

Cr Derivative liability £1,623

\$100,000 at the exchange rate at settlement date 1.55 (£64,516) less £62,893

Debtor and derivative settlement

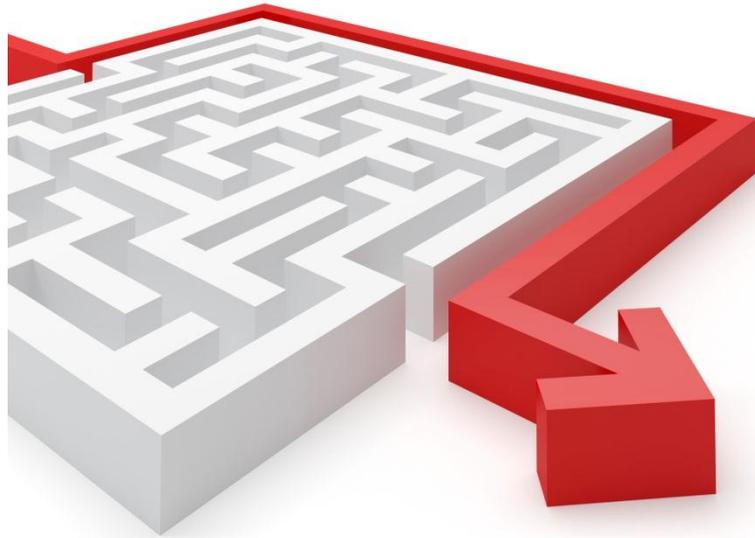
3. Dr Cash £61,728 (\$100,000 at the contracted rate 1.62)

Dr Derivative liability £2,788

Cr Debtors £64,516

What is the overall effect of FRS 102?

FRS 102 is merely reporting gains/losses in different periods, which cumulatively have no effect over the two accounting periods in these examples.



Disclaimer

This guide is intended for companies and their directors. The guide contains a summary of key differences based on current interpretation and should not be considered an exhaustive list of all differences between existing UK GAAP and FRS 102. Neither does the guide address or purport to address the special requirements of entities subject to the accounting requirements of a Statement of Recommended Practice (SORP). You should therefore take appropriate professional advice before taking any further action. Hazlewoods cannot be held liable for any action or business decision taken on the basis of information in this guide. (July 2015)

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