

Technical Update

February 2011

Changes to the proposals for FRSME

UK GAAP's time is limited! The IASB has introduced the IFRS for SMEs, for adoption worldwide, and in the UK the ASB has taken this version and adapted it for UK purposes. An exposure draft was issued in October 2010 in relation to the Financial Reporting Standard for Medium-sized Entities (FRSME).

When the FRSME (the UK version of the IFRS for SMEs) has been adopted it will apply to what will be known as Tier 2 companies. Tier 1 will be required to adopt or continue to adopt IFRS and Tier 3 will be entitled to continue applying the FRSSE.

Tier 1	Tier 2	Tier 3
<p>Listed entities required to prepare accounts under EU adopted IFRS</p> <p>Publicly accountable entities i.e. those entities whose debt or equity instruments are traded publically or who hold deposits or manage assets for outsiders. i.e. banks, credit unions, insurance companies.</p>	<p>Medium and large entities who do not have public accountability</p>	<p>Companies which fall under the definition of small and can apply the FRSSE</p>

The effective date is expected to be periods commencing on or after 1 July 2013 but consideration will need to be given to the comparatives, and also the starting position of comparatives, as they will also need to be restated i.e. as at 30 June 2012.

The FRSME is an abridged version of the full IFRS – it is only 400 pages long compared to UK GAAP's 2,000 pages and the 2,800 pages of IFRS. It should be noted however that even the FRSME differs from IFRS in some aspects of accounting treatment.

So, how will financial statements change?

Certain aspects of the FRSME remain the same as UK GAAP but there are a few notable differences that will have an impact:

Tangible fixed assets - The revaluation of fixed assets will no longer be permitted, however there will be a choice as to the "deemed" cost to carry forward upon transition. Consideration to any banking covenants relying on asset values may be needed with supplemental valuations done for bank purposes only.

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Borrowing costs – All borrowing costs will be required to be expensed instead of the current treatment of capitalising within the cost of the asset.

Investment properties – The property should be revalued to fair value with the revaluation going direct to the profit and loss account – not to a revaluation reserve. There would be the ability to carry at cost less depreciation though in situations where the fair value cannot be easily obtained.

Goodwill and intangible assets – UK GAAP has always presumed a maximum life of 20 years, unless it can be rebutted, however the maximum amortisation period will be reduced to 10 years, 5 years for goodwill on consolidations.

Development costs – These will have to be expensed as incurred rather than capitalised when certain criteria are met. For those companies with development expenditure this will result in a significant increase in expenses.

Government grants – Unlike UK GAAP the income should be recognised when received unless there are specific performance criteria. This will have the impact of potentially advancing revenue into the accounts, even if expenses have not yet been incurred.

Business combinations – Merger accounting will no longer be allowed – only acquisition accounting in respect of business combinations will be acceptable.

Financial instruments – There will be two forms of financial instrument: basic and other. Basic will be measured at amortised cost and other instruments will be fair valued through the profit and loss account. How this differs from UK GAAP depends on the level of adoption of previous UK standards.

Deferred tax – The current UK method of calculation is based on timing differences, whereas under the FRSME the temporary method is used. This looks at balance sheet adjustments as well as profit and loss adjustments.

As previously mentioned the FRSME is still an exposure draft and further changes may still be made before we see the final adopted version.

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