

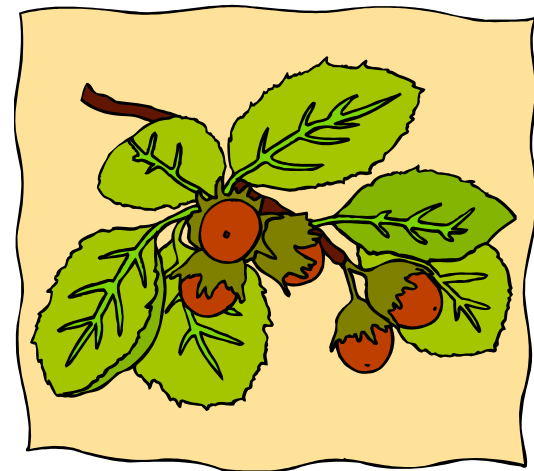
The Future of UK Financial Reporting

Nickie Paul



Proposals - In a nutshell

- No change for quoted groups or those eligible to use FRSSE
- A new Financial Reporting Standard for Medium Sized Entities (FRSME) is proposed for unquoted companies currently applying UK GAAP (based on IFRS for SMEs)
- Reduced disclosure for subsidiaries but some unquoted entities with public accountability will be required to apply IFRS.
- UK Corporate reporters will be in tier 1, 1s, 2, 2s or 3
- The new regime may come into force by mid 2013
- Revised Statements of Recommended Practice (SORPS) are likely to be issued.
- Wide-ranging implications as not only affects financial statements but also tax, banking arrangements, systems and performance management.



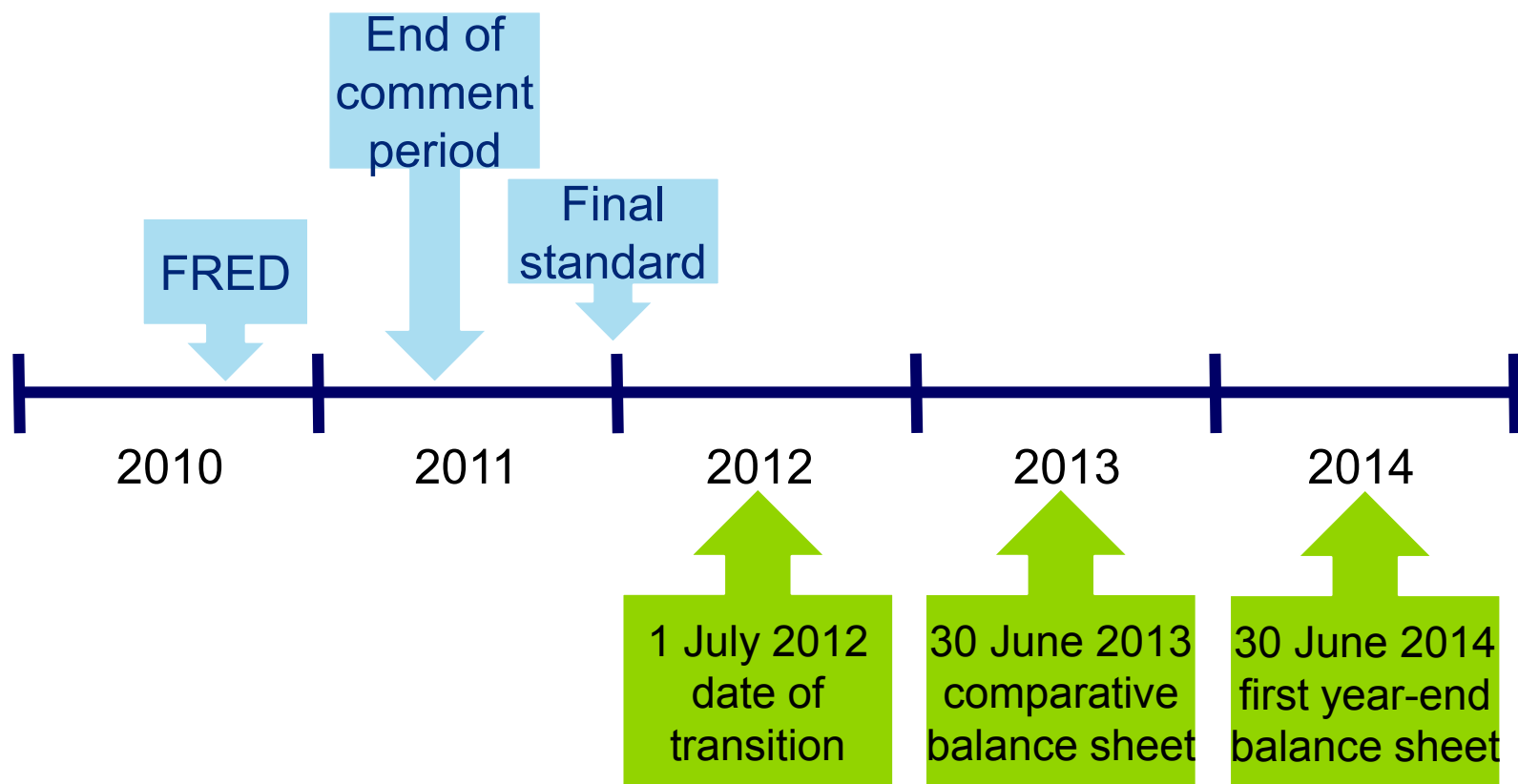
Why is a change proposed?

- Increasing complexity of UK accounting standards and the need to update them.
- UK standards have developed over decades to reflect changing economic circumstances and activities and adapted to include changes in International Accounting Standards creating an unwieldy book of 2000 pages!
- ASB believe the most logical approach is to extend the IFRS based framework
- Ability to adopt a simplified version with the advent of IFRS for SMEs
- Reduce costs of reporting and training accountants given reporting would be based on a single framework going forward

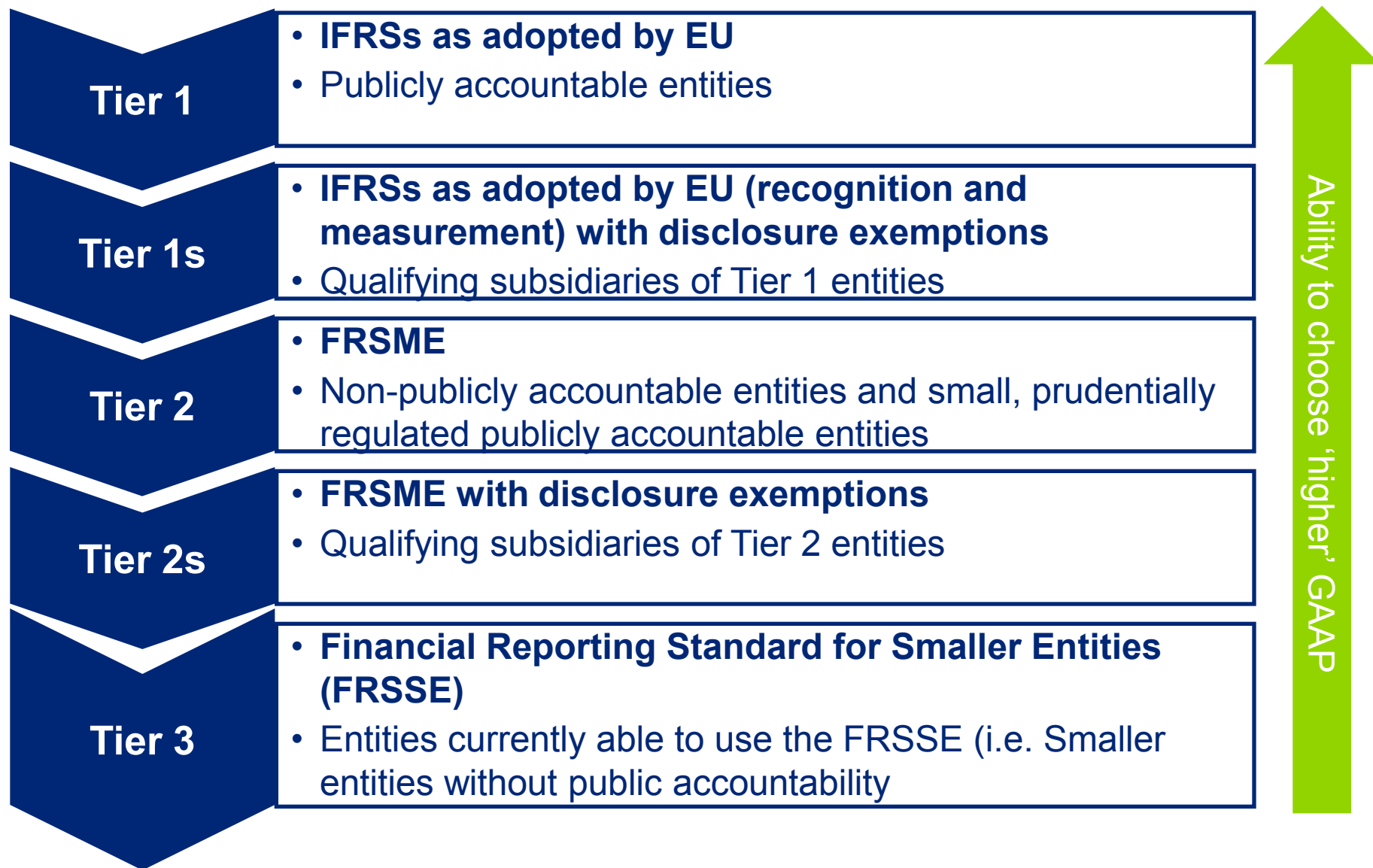


The ASB's FRED – published October 2010

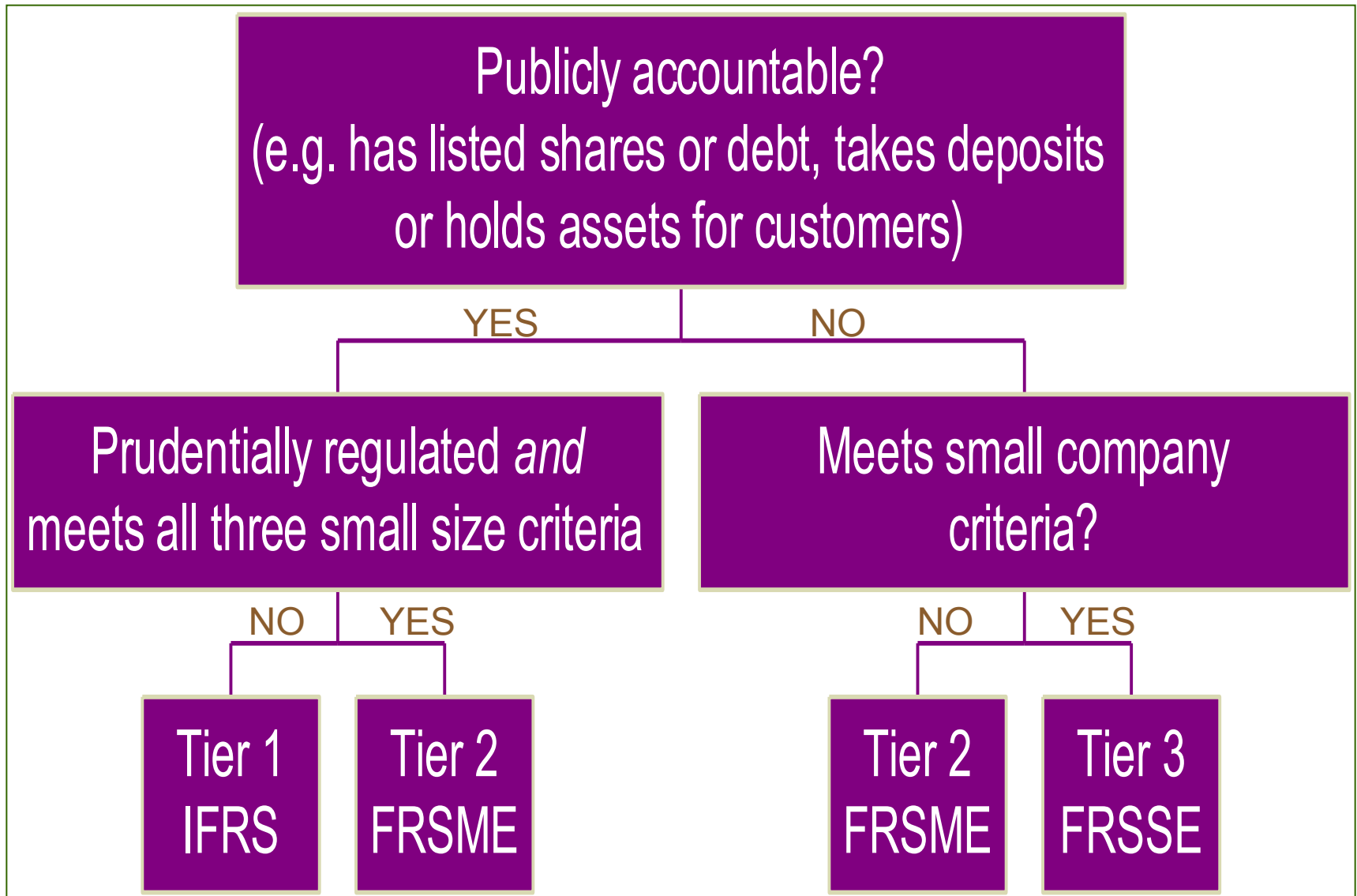
- Comments due by 30 April 2011, final standard by end of 2011
- Effective for periods beginning on or after 1 July 2013



The ASB's proposed tier structure



The ASB's proposed tier structure – Flow chart

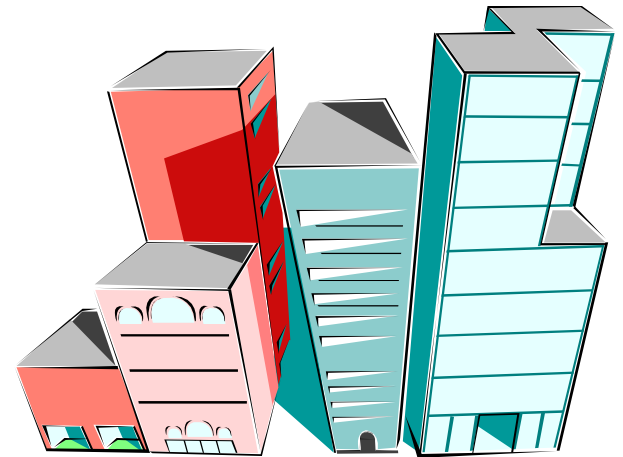


Public accountability

Definition:

“An entity has public accountability if:

- as at the reporting date, its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market; or
- as one of its primary businesses it holds assets in a fiduciary capacity for a broad group of outsiders and/or it is a deposit taking entity for a broad group of outsiders.



Am I publicly accountable?

Banks, building societies, credit unions etc

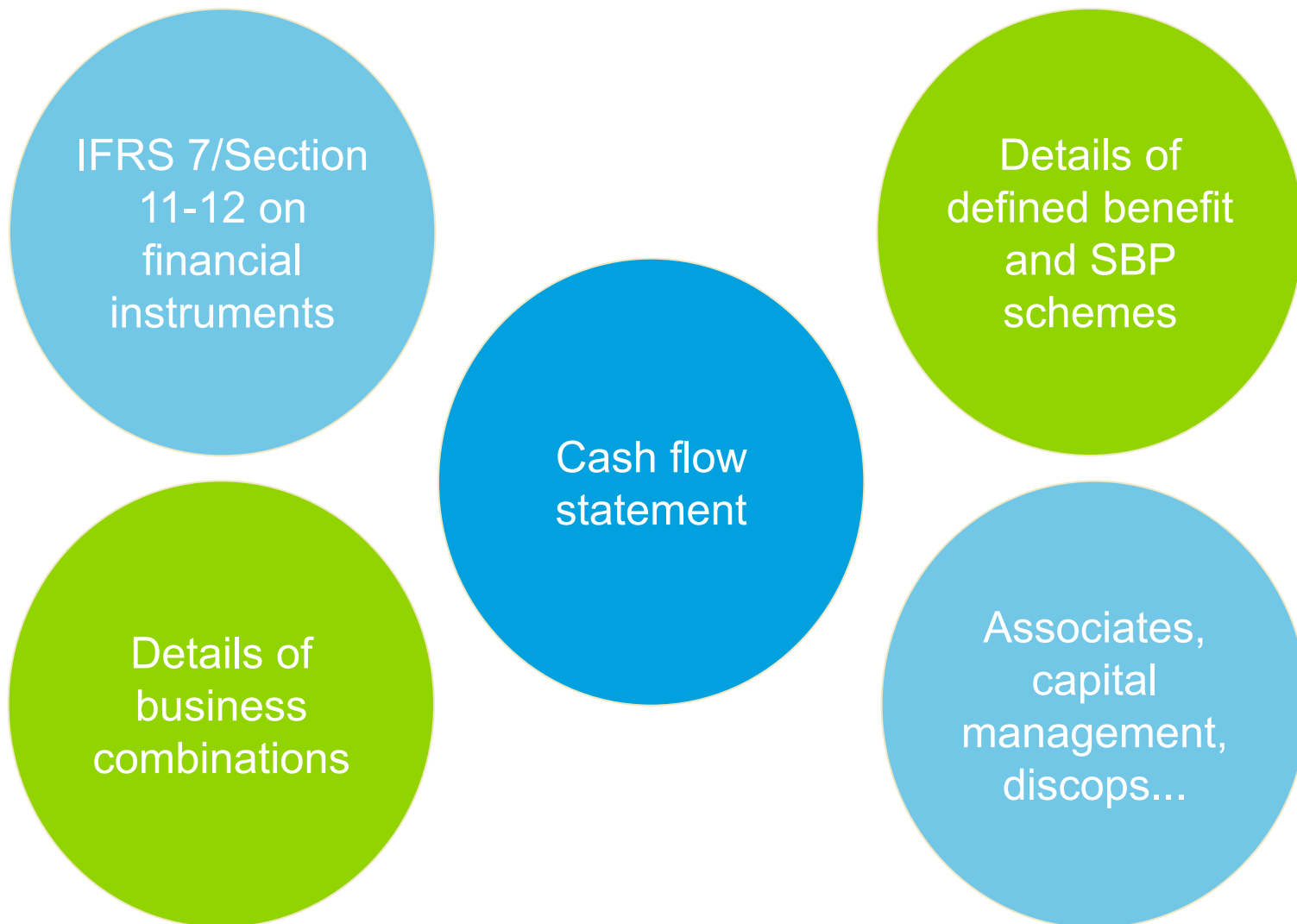
Insurance companies

Quoted companies and groups

Pension schemes and EBTs

Investment trusts, stockbrokers, unit trusts...

Disclosure exemptions for qualifying subsidiaries



Exemptions - summary

Exemptions for subsidiaries	Tier 1s	Tier 2s
Presentation of a cashflow statement	✓	✓
Disclosures on the valuation and effect of share-based payments*	✓	✓
Financial instruments disclosures under IFRS 7/Sections 11 & 12 of FRSME	✓	✓
Detailed disclosures on defined benefit schemes*	✓	✓
Detailed disclosures on business combinations apart from the fair values of consideration paid and assets and liabilities acquired	✓	N/A**
Analysis of net income or expense from discontinued operations*	✓	N/A
Comparative information on movements in property, plant and equipment, intangible asset and investment property balances	✓	N/A
Disclosures on management of the company's capital	✓	N/A
IFRSs issued but not effective	✓	N/A
Detailed disclosures in respect of associates*	✓	N/A
Some assumptions and sensitivities significant for an impairment review	✓	N/A

* Exemption only available where equivalent disclosures are included in consolidated financial statements

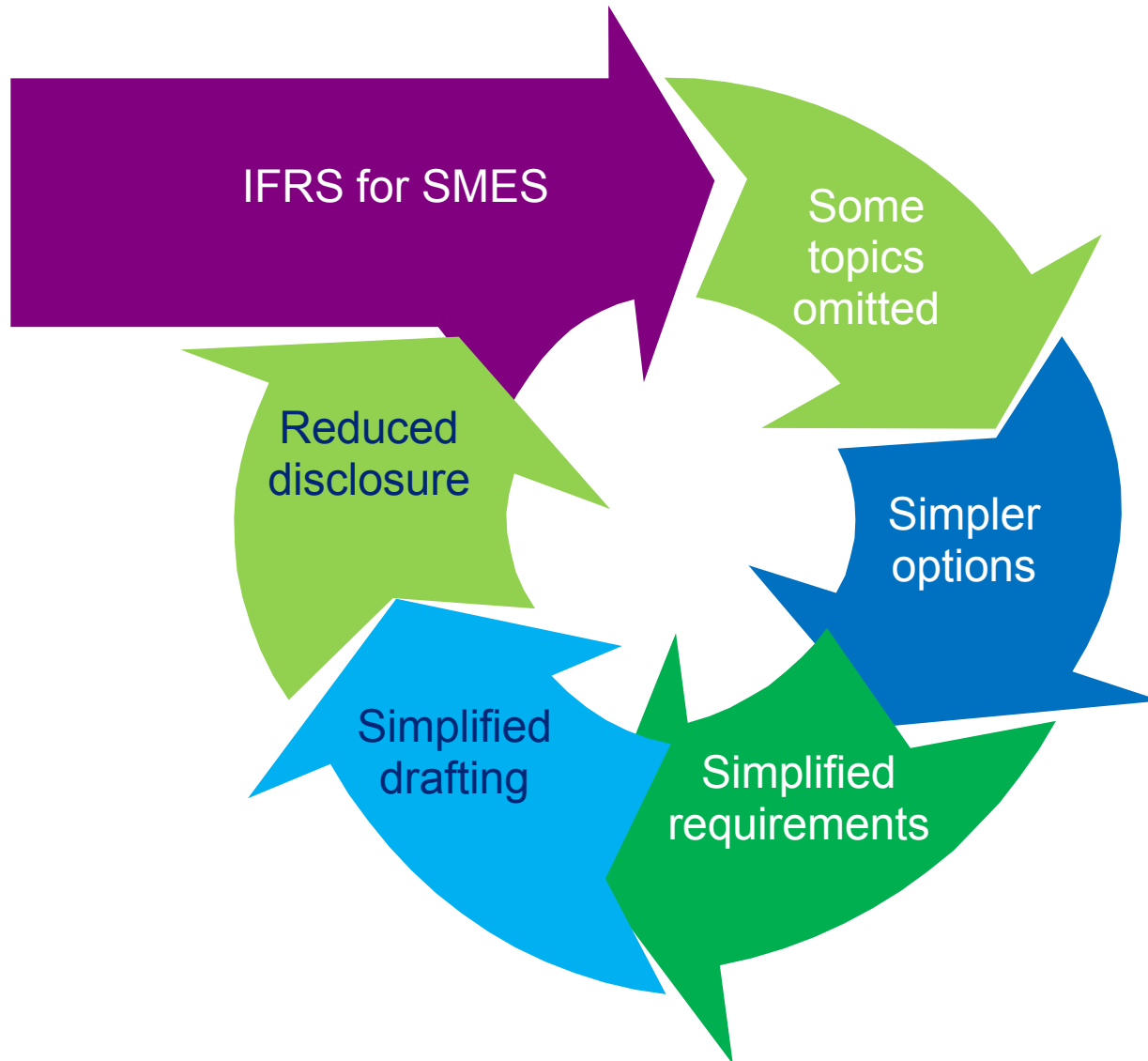
** Disclosures only required by FRSME and hence no exemption required.

Still under development

- Public benefit entities
 - ‘Differences only’ standard to be developed in 2011
- SORPs
 - Retained and updated where there is a clear and demonstrable need but otherwise withdrawn/phased out:
 - Retain – Pension schemes, LLPS, Investment companies, Authorised funds,
 - Withdraw – Insurance, Leases, Banks – segments
- Disclosure of intercompany transactions
 - No exemption in FRED, but views requested on retaining FRS 8 exemption

IFRS for SMEs (FRSME) in a nutshell

IFRS for SMEs in a nutshell

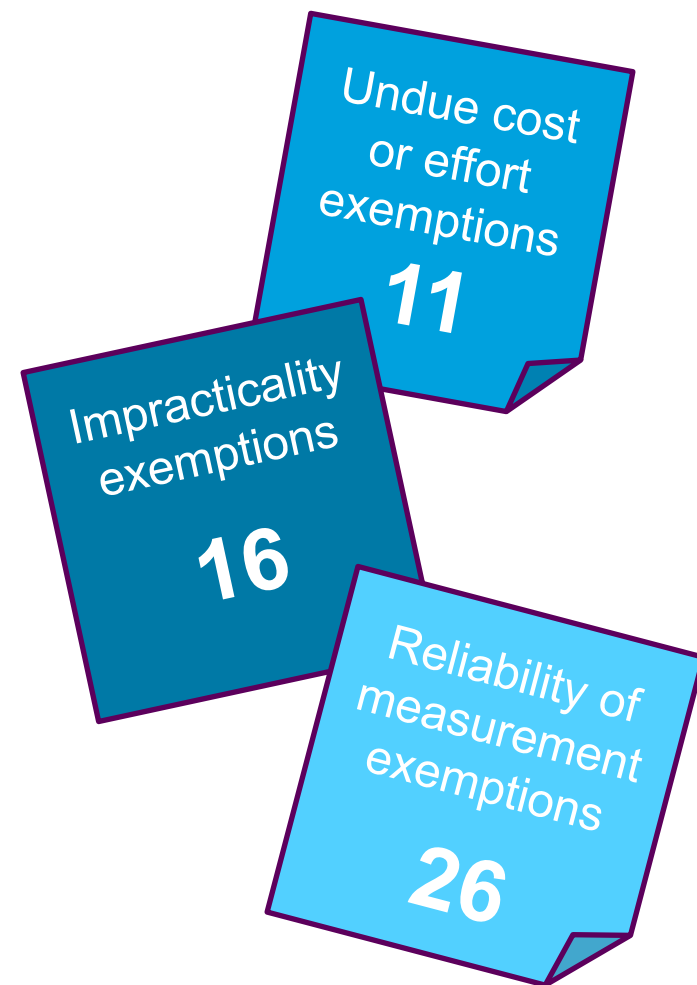


Omitted topics

- Segment reporting
- Interim reporting
- Earnings per share
- Insurance
- Special accounting for assets held for sale

Recognition & measurement simplifications

- Financial instruments
- Goodwill and indefinite life intangibles
- Research and development costs
- Associates and jointly-controlled entities
- Borrowing costs
- Defined benefit plans
- Share-based payments
- Biological assets



Financial instruments - measurement

Basic/non-basic distinction in line with IFRS 9

'Basic' instruments at amortised cost	'Non-basic' instruments at FVTPL
Trade receivables and payables	Forwards, swaps, options...
Fixed rate loan	Loan with complex terms (contingent prepayment terms, indexed interest payments etc)
LIBOR + margin loan	Lease with variable rental payments not based on the price of the asset

- Limited and specific exceptions to this model
 - Quoted shares at FVTPL
 - Shares with no reliable FV available and commitments to receive a loan at cost less impairment
- Basic/non-basic distinction applies to assets & liabilities

Financial instruments – hedge accounting

Types of hedging instruments permitted for hedge accounting	Permitted
Interest rate swap to hedge interest rate risk on debt instrument measured at amortised cost	✓
Foreign currency loan for a hedge of foreign currency risk	✗
A future contract to hedge foreign currency risk in a highly probable forecast transaction	✓
A purchased interest rate cap to hedge a variable interest rate debt	✗
Cross-currency interest rate swap to hedge both interest rate and foreign currency	✗
A forward contract to hedge commodity price risk in a commodity held	✓

Key differences from full IFRS & UK GAAP

Full IFRSs	IFRS for SMEs	UK GAAP
No amortisation of goodwill	Amortisation over UEL, (or 10 years)	Amortisation over UEL max 20 years - rebuttable
Capitalisation of development costs mandatory	Internally developed intangibles, including development costs expensed	May capitalise development costs if conditions met
Revaluation of fixed assets allowed	Revaluation prohibited	Revaluation allowed
Capitalisation of borrowing costs required	Capitalisation of interest prohibited	Capitalisation of interest allowed
Multi-employer exemption not available for group DB schemes	Same as full IFRS	Multi-employer exemption available for group schemes

Key differences from full IFRS & UK GAAP

Full IFRSs	IFRS for SMEs	UK GAAP
Investment property at cost or FVTPL	Use cost unless FV can be measured reliably without undue cost or effort in which case use FVTPL	Mandatory revaluation to open market value through STRGL
Acquisition method - fair value exchange approach, attributable costs are expensed & adjustments to contingent consideration generally to P&L	Acquisition method - cost approach, attributable costs capitalised & adjustments to contingent consideration against goodwill	Acquisition accounting using a cost approach
No merger accounting (unless common control)	No merger accounting (unless common control)	Merger accounting if conditions met
Transactions recorded in functional currency	Same as full IFRS	SSAP 20 uses local currency

Key differences from full IFRS & UK GAAP

Full IFRSs	IFRS for SMEs	UK GAAP
No exemptions for cash flow statements or intra-group RP transactions	Same as full IFRS	Exemptions for subsidiaries
Complex mixed cost/FV model involving four asset categories, recycling of gains from equity, separation of embedded derivatives and restrictive hedging rules	In general 'basic' financial instruments at cost, and 'complex' instruments at FVTPL, limited hedge accounting permitted, option to use full IFRS	Comparatively few rules on financial instruments. Some use full IFRS accounting (FRS 26)
Associates accounted for using equity method. JCEs (currently) have choice: equity method or proportionate consolidation	Option to use cost (unless quoted), equity method or FVTPL	Associates/JVs accounted for using equity/gross equity method

FRSME vs IFRS for SMEs

- Tax chapter replaced by IAS 12
 - IFRS for SMEs based on ED not being taken forward
 - No exemptions or reduction in disclosure requirements
- Other changes to comply with EU directives
 - Consolidation only required when required by law
 - Equity accounting for associates/JVs required in consolidated accounts
 - Negative goodwill recognised and amortised
 -etc

Further information

ASB website

Key facts :

http://www.frc.org.uk/images/uploaded/documents/Key%20Facts2010_web%20optimised.pdf

FRED:

<http://www.frc.org.uk/images/uploaded/documents/Part%201%20Web%20Optimized.pdf>

FAQs:

http://www.frc.org.uk/documents/pagemanager/asb/Future_of_UK_GAAP/FRED_Oct_2010/Frequently%20Asked%20Questions%20mids%20JF%20final.pdf

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