

Choosing your GAAP

Planning for the proposed removal of UK GAAP



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Notes

While its detailed accounting provisions are broadly consistent with full IFRS, there are key differences and simplifications. The following are the key simplifications made:

- some topics in full IFRS are omitted because they are not relevant to typical SMEs e.g. segmental reporting, assets held for sale and earnings per share;
- some accounting policy treatments in full IFRS are not allowed because a simplified method is available to SMEs e.g. the revaluation model for property, plant and equipment and intangible assets is not allowed; and
- easing of recognition and measurement principles that are in full IFRS e.g. simplified calculation of defined benefit pension plan obligations in some circumstances.

The detailed provisions are discussed further on pages 7 to 10.

When will UK accounting standards die?

In recent years, the UK Accounting Standards Board (ASB) has consulted with its constituents over the future of UK GAAP. The ASB believes only one accounting framework is needed in the UK and it should be based on IFRS. To date, commentators have broadly supported the ASB's view.

The ASB is expected to issue in August 2009 its Paper seeking views on its proposal to replace current UK GAAP by adopting the IFRS for SMEs. The Paper is expected to propose that the new regime takes effect for accounting periods beginning on or after 1 January 2012, an ambitious target. The IFRS for SMEs will then be available for use by all UK companies except those with public accountability who will use full IFRS.

What does 'public accountability' mean?

An entity has public accountability if:

- 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
- it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, building societies, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

Notes

A major selling point of the ASB's plans is that the FRSSE will continue to be available to the two million or more small companies and businesses in the UK. They are therefore not facing any significant changes over the next three years. The entities directly affected by these plans are the 50,000 or so larger companies currently using full UK GAAP. These entities include:

- companies which are listed and have not adopted IFRS in their individual financial statements;
- subsidiaries in listed groups who have not adopted IFRS throughout the group;

Where consolidated accounts are prepared using IFRS, company law allows a free choice of using UK GAAP or IFRS for the company's individual financial statements. Deloitte research shows that half of UK listed companies still use UK GAAP in their parent company only accounts and thus use UK GAAP for their UK subsidiaries. Many others use IFRS for the parent company only accounts but continue to use UK GAAP for subsidiaries.

- all public limited companies which are not publicly accountable; and
- all private groups and companies, except those which may qualify as small by having two out of three of:
 - turnover less than £6.5m (£7.8m gross in groups);
 - balance sheet total less than £3.26m (£3.9m gross in groups); and
 - not more than 50 employees.

Why will the ASB drop UK accounting standards?

Maintaining UK GAAP and IFRS frameworks, which are partly converged, is not desirable in the long term and is challenging for those who have to keep up to date with the two sets of accounting requirements. The number of entities within the scope of full UK GAAP has been decreasing in recent years as groups traded on AIM and public sector entities move to IFRS. The ASB has not sought to develop UK GAAP since 2004 and so it has become a patchwork of very old SSAPs, FRSs issued by the ASB as an independent standard setter in the 1990s/early 2000s and FRSs based on their international equivalents and issued from 2004. IFRS is seen as the global language of accounting. With the IFRS for SMEs being available, it is now time to drop UK accounting standards.

What are the choices?

The 'middle tier' face a choice of whether to leap to full IFRS or to step to the new IFRS for SMEs. The following chart shows the options expected to be available to companies and groups.

	FRSSE	IFRS for SMEs	Full IFRS
Listed companies*			✓
Companies traded on AIM*			✓
Companies traded on other stock exchanges*			✓
Unlisted private companies with public accountability			✓
Unlisted companies without public accountability		✓	✓
Subsidiary within a listed group currently applying IFRS		**	✓
Medium-sized companies		✓	✓
Small companies	✓	✓	✓

* Also applies to their consolidated accounts which may already have to use full IFRS.

** See first question opposite.

Consideration of new regimes inevitably gives rise to many questions. Answers to some of the expected questions in relation to this transition are noted opposite.

Notes

Notes

1. Can companies, such as subsidiaries of listed groups that have already made the move to full IFRS change to use the IFRS for SMEs?

Under current UK law, an entity which opts to produce financial statements in accordance with IFRS cannot switch back to preparing UK GAAP accounts unless there is a 'relevant change of circumstance' e.g. the company becomes a subsidiary of another undertaking that does not prepare its accounts under IFRS. The IASB allows entities to move from full IFRS to IFRS for SMEs. On the assumption that IFRS for SMEs would become UK GAAP (see question 4 below) it would be necessary to clarify that the introduction of IFRS for SMEs is a 'relevant change in circumstance', so entities could switch from full IFRS to IFRS for SMEs.

2. Full IFRS or IFRS for SMEs?

Those companies faced with the choice will need to weigh up the pros and cons of both regimes for their particular circumstances. As well as the accounting differences in recognition and measurement and the differences in disclosure requirements between the two regimes, there are a number of other factors to consider. Is the company considering listing in the near future? What are competitors doing? How complex is the company? Does the company currently adopt FRS 26 on financial instruments? Pages 11 and 12 set out further matters for consideration.

3. Same regime for all entities in a group?

Currently many listed groups choose to prepare their parent company individual accounts and subsidiary accounts in accordance with UK GAAP. As the parent company is publicly accountable it will not be eligible to use IFRS for SMEs and will have to use full IFRS. Similarly if there were vehicles in the group with listed debt or holding assets in a fiduciary capacity, they would have to use full IFRS. Current UK law states that a parent company and its subsidiary undertakings must prepare their accounts using the same accounting framework unless there are good reasons not to do so. The Department for Business, Innovation and Skills (BIS) set out, in a note on its website, what might constitute 'good reasons'. Clarification will be welcomed from the ASB or BIS on whether groups will have the free choice of IFRS for SMEs or full IFRS for their non publicly accountable subsidiaries.

4. Why does IFRS for SMEs have to be adopted by the ASB and not used directly?

The ideal position would be for the European Commission to recognise IFRS for SMEs as part of the IAS Regulation. This would have direct effect in the UK and would mean that UK companies would not be required to consider the detailed accounting provisions in company law emanating from the EU's Fourth and Seventh Company Law Directives. While many are asking for this, the battles over IFRS in Europe appear to have left some war-weary to initiate another fight to have IFRS for SMEs directly recognised in European legislation.

Key areas of accounting and tax impact

Transitioning to IFRS for SMEs or full IFRS is likely to mean a change in the recognition and measurement of a number of items in the financial statements. The list that follows is by no means exhaustive. It indicates the more significant accounting differences between UK GAAP and the IFRS for SMEs. Where the IFRS for SMEs differs significantly to full IFRS this is noted in italics. The impact of changing GAAP is not restricted to accounting. The implications for tax can be significant. An indication of the possible consequences for cash tax and on the effective tax rate of moving to a new regime is also given below.

Notes

Topic	Comparison of IFRS for SMEs, UK GAAP and Full IFRS	Tax impact of IFRS for SMEs	
		Cash tax impact	Effective tax rate (ETR)/deferred tax
Goodwill and intangibles	<p>All internally developed intangibles, including development costs, must be expensed.</p> <p>Capitalisation of development costs permitted if conditions met.</p> <p><i>Capitalisation of development costs mandatory.</i></p> <p>Acquired intangibles (including goodwill) must be amortised. Default useful life 10 years.</p> <p>Mandatory amortisation. Assumed maximum useful life 20 years.</p> <p><i>Goodwill and indefinite life intangibles are not amortised.</i></p>	<p>Expensing all internal costs may allow an upfront deduction of all revenue development costs rather than just qualifying research and development.</p> <p>Use of shorter useful life may accelerate tax deduction.</p> <p>May need to consider transfer pricing.</p>	<p>No impact on ETR where deferred tax is provided under UK GAAP.</p>
Investment property	<p>Use cost unless fair value can be measured reliably without undue cost or effort in which case use 'fair value through profit and loss' (FVTPL).</p> <p>Mandatory revaluation to 'open market value' through the STRGL.</p> <p><i>Option to use cost or FVTPL.</i></p>	<p>No effect since investment properties are taxed on a chargeable gains basis.</p>	<p>Deferred tax will be required on all temporary differences including revaluations.</p>

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Topic	Comparison of IFRS for SMEs, UK GAAP and Full IFRS	Tax impact of IFRS for SMEs	
		Cash tax impact	Effective tax rate (ETR)/deferred tax
Foreign currency	<p>Transactions recorded in functional currency.</p> <p>Option:</p> <ul style="list-style-type: none"> SSAP 20 permits use of a 'local' currency. FRS 23 same as IFRS for SMEs. <p>Same as IFRS for SMEs.</p>	<p>Significant effect where entities have used the 'local' currency approach in SSAP 20. The resulting FX movements taken to profit or loss as a result of the functional currency approach will be taxable causing significant volatility in cash tax payable on an annual basis.</p>	<p>No ETR impact where any deferred tax is fully provided.</p>
Business combinations	<p>Acquisition method using a cost approach – attributable costs capitalised, and adjustments to contingent consideration against goodwill.</p> <p>Acquisition accounting using a cost approach. Merger accounting permitted if conditions met.</p> <p>Acquisition method using a fair value exchange approach – attributable costs are expensed, and adjustments to contingent consideration generally to profit or loss.</p>	<p>Possible effect where negative goodwill is written off to profit or loss.</p> <p>No effect for transaction costs as they are generally disallowed for tax purposes.</p>	<p>Deferred tax will arise on business combinations where fair values allocated to assets and liabilities are different to the underlying tax base due to use of temporary difference approach.</p> <p>Where disallowable costs are capitalised the ETR will reduce.</p>
Cash flow statements	<p>Cash flow statement is required in every set of financial statements, including subsidiaries.</p> <p>Exemptions for 90% owned subsidiaries and other entities.</p> <p>Same as IFRS for SMEs.</p>	<p>No tax impact.</p>	

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Designed and produced by The Creative Studio at Deloitte, London. 31951

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