

How will moving from UK GAAP to the IFRS for SMEs from 2012 impact on my company's accounts?

The Accounting Standards Board has proposed replacing existing UK GAAP with the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) for UK companies that are not publicly accountable. This change is planned for 2012. The introduction of the IFRS for SMEs will have a major impact on the financial statements of any entity currently preparing accounts under UK GAAP. This factsheet focuses on the major changes from UK GAAP for non-small companies that will impact the financial statements of many companies on switching to the IFRS for SMEs.

There will be significant changes to the format of the financial statements and the disclosures required, but most importantly for many businesses there will be changes to the numbers as well. The IFRS for SMEs will change the recognition criteria for various assets and liabilities, the basis on which many items are measured and the treatment of certain gains and losses.

The starting point for applying the IFRS for SMEs will be to restate the opening balance sheet at the start of the comparative period for the first accounts prepared under the IFRS for SMEs. This is known as the date of transition. If a company prepares its first accounts under the IFRS for SMEs for the year ending 31 December 2012, its date of transition will be 1 January 2011. The IFRS for SMEs includes provisions to ease the transition.

Property, plant and equipment

Property, plant and equipment is the equivalent term in the IFRS for SMEs for tangible fixed assets in UK GAAP.

Measurement basis

Under the IFRS for SMEs there is no option to revalue property, plant and equipment. Instead, it must be measured at cost, less accumulated depreciation and any impairments.

Borrowing costs

Under UK GAAP, there is an accounting policy choice regarding the capitalisation of finance costs directly attributable to construction of a tangible fixed asset. Under IFRS for SMEs, there is no such choice: all borrowing costs are recognised as an expense as incurred.

Investment property

UK GAAP requires investment properties to be revalued each year to open market value. The IFRS for SMEs requires revaluation each year to fair value, with value changes taken to profit or loss. It does allow the cost less depreciation model to be used if fair value cannot be measured reliably without undue cost or effort.

Highlights

The IFRS for SMEs will change not only the format of, and disclosures in, financial statements but also:

- the criteria for recognition of some assets and liabilities
- the measurement basis of some items
- the treatment of some gains and losses.

Financial instruments

The IFRS for SMEs classifies financial instruments into 'basic' and 'other'. (Companies also have the option of adopting the recognition and measurement criteria of IAS 39 *Financial Instruments: Recognition and Measurement*, with the disclosures as specified in the IFRS for SMEs.)

Basic financial instruments

These are items such as trade receivables (debtors), trade payables (creditors) and straightforward bank loans. They are mostly measured at amortised cost, with certain types being measured at cost or fair value. However, most receivables and payables that are classified as current assets or current liabilities are measured at the undiscounted amount of cash expected to be paid or received.

Other financial instruments

This category includes instruments such as foreign exchange forward contracts and loans with complex provisions. These are almost all measured at fair value at each balance sheet date with movements recognised in profit or loss. Many of these instruments would not have been recognised on the balance sheet under UK GAAP, but simply disclosed. Hedge accounting is permitted under IFRS for SMEs only for certain specified types of hedges.

Accounting for business combinations

The IFRS for SMEs requires consolidated accounts to be prepared, the principal exception being where a parent company is part of a larger group. The IFRS for SMEs requires the use of the purchase method (acquisition accounting) for all business combinations within its scope, although the standard does not address common control transactions.

Associates and joint ventures

In consolidated financial statements

Under the IFRS for SMEs, there is a choice between three approaches: the cost model, the equity method and the fair value model. However, the fair value model is required where there is a published price quotation for an investment. Under

UK GAAP there is no choice: joint ventures are accounted for using the gross equity method while associates are accounted for using the equity method.

In individual ('separate') financial statements

In a parent's separate financial statements under the IFRS for SMEs, all investments in subsidiaries, associates and joint ventures are accounted for either at cost less impairment or at fair value. Similar options are available under UK GAAP, where the choice is between cost less amounts written off or valuation. Under UK GAAP revaluation movements are taken to a revaluation reserve whereas under the IFRS for SMEs fair value movements are recognised in profit or loss.

Intangible assets and goodwill

Useful economic lives

For intangible assets and goodwill, UK GAAP presumes a maximum useful life of 20 years, but this can be rebutted if a longer or indefinite life can be justified. Under the IFRS for SMEs, all such assets have a finite life. If no reliable estimate can be made, the useful life is presumed to be ten years.

Measurement of intangible assets

The IFRS for SMEs requires intangible assets to be measured at cost less accumulated amortisation and impairment losses. Unlike UK GAAP, revaluation of intangible assets is not permitted in any circumstances.

Capitalisation of development costs

Capitalisation of development costs is permitted under UK GAAP as long as strict criteria are met. However, no capitalisation of any internal expenditure is permitted under the IFRS for SMEs, which explicitly states that development expenditure must be expensed when it is incurred.

Recognition in business combinations

The criteria for recognition of the identifiable assets and liabilities of an acquiree differ from UK GAAP, where such assets and liabilities have to be capable of being disposed of or settled separately. There is no equivalent 'separation' requirement in the IFRS for SMEs, meaning more intangible assets are likely to be identified separately from goodwill.

Defined benefit pension schemes

The valuation method under the IFRS for SMEs is the projected unit credit method, as under UK GAAP. However the IFRS for SMEs provides a number of simplifications where this basis would require undue cost or effort. The IFRS for SMEs also does not require use of an independent actuary, compared to the requirement under UK GAAP to obtain a valuation by a qualified actuary at least every three years.

Deferred tax

UK GAAP takes a timing difference approach to deferred tax, based on the mismatch between the periods in which gains and losses are recognised in the financial statements and the period in which the tax effects arise. The IFRS for SMEs takes a temporary difference approach, based on the difference between the carrying amount of an asset or liability in the financial statements, and the effect on taxable profit if the asset had been sold or liability settled at the balance sheet date. Although the differences appear subtle, the change is likely to make the calculation of deferred tax more complex and give rise to deferred tax in more situations.

Discounting of deferred tax balances is a permitted treatment in UK GAAP but is not allowed under the IFRS for SMEs.

Foreign exchange

Foreign exchange forward contracts

Under SSAP 20 *Foreign currency translation* in UK GAAP, where matching forward contracts are in place for a transaction, the contracted rate can be used for translation of the transaction. This option is not permitted under the IFRS for SMEs (or IFRS 23). Instead, a foreign exchange forward contract will be recognised on the balance sheet as a financial instrument at fair value.

Presentation currency

The IFRS for SMEs allows translation of financial statements into any currency ('presentation' currency) from its 'functional currency' (broadly equivalent to local currency). Under UK GAAP, accounts are prepared in the local currency.

Agriculture

The IFRS for SMEs gives specific guidance for agricultural activity. Biological assets (living animals and plants) are measured at fair value less costs to sell, unless this is not readily determinable, in which case the cost can be used.

Cash flow statements

The IFRS for SMEs requires a cash flow statement in all cases, with no exemptions for subsidiary companies.

Who should I contact for assistance?

Andrew Howie

Partner

T 0141 223 0697

M 07887635177

E andrew.howie@gtuk.com