Financial Reporting Council

Accounting and Reporting Policy
FRS 102

Staff Education Note 13
Transition to FRS 102

This Staff Education Note was updated on 8 January 2014 for minor typographical errors in the suggested reconciliations on pages 11 to 13.

Disclaimer
This Education Note has been prepared by FRC staff for the convenience of users of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. It aims to illustrate certain requirements of FRS 102, but should not be relied upon as a definitive statement on the application of the standard. The illustrative material is not a substitute for reading the detailed requirements of FRS 102.

Contents

Introduction

Section 35 *Transition to this FRS* of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* applies to the first-time adoption of FRS 102 and sets out how an entity prepares its first financial statements that conform with that standard.

FRS 102 will be effective for accounting periods beginning on or after 1 January 2015, although early application is permitted. It requires the comparative and opening balance sheet at the date of transition to be restated in accordance with FRS 102; the date of transition being the beginning of the earliest period for which an entity presents full comparative information. However, the opening balance sheet itself does not need to be presented.

FRS 102 requires the presentation of reconciliations of equity determined in accordance with its previous financial reporting framework and its equity determined in accordance with FRS 102 at two dates:

(a) the date of transition to FRS 102; and

(b) the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework.

FRS 102 requires the presentation of a reconciliation of profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with FRS 102 for the same period.

For example, for an entity with a 31 December year end, the first year of mandatory application will be the year ending 31 December 2015. The entity will need to restate its opening balance sheet at the date of transition (ie at 1 January 2014) and comparative balance sheet (ie at 31 December 2014) in accordance with FRS 102, although the opening balance sheet need not be presented. The entity will need to prepare reconciliations of equity at 1 January 2014 and 31 December 2014 and of its profit or loss for the year ending 31 December 2014.

This Staff Education Note is written to highlight key areas of consideration when transitioning to FRS 102 and is not designed to be exhaustive.

Transitional procedures

FRS 102 requires the balance sheet at the date of transition to be prepared in accordance with the recognition and measurement requirements of FRS 102.

Required amendments – Retrospective restatement

For an entity with a date of transition of 1 January 2014, it is required to restate its balance sheet at 31 December 2013 by making the adjustments that are necessary to recognise and measure all assets and liabilities in accordance with FRS 102.

Paragraph 35.7 of FRS 102 requires an entity to:

(a) recognise all assets and liabilities whose recognition is required by FRS 102 (eg forward exchange contracts);

(b) not recognise items as assets or liabilities if FRS 102 does not permit their recognition;

(c) reclassify items (eg into different groupings in the cash flow statement); and

(d) restate certain assets and liabilities at a different value (eg financial instruments measured at amortised cost using the effective interest rate, which in some cases may vary from a previously used historical cost).

Paragraph 35.8 states that adjustments on transition shall be recognised in retained earnings, or where appropriate, another category within equity.

Exceptions to retrospective restatement

Paragraph 35.9 states that on first-time adoption of FRS 102, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

(a) ***Derecognition of financial assets and financial liabilities:***
Financial assets and liabilities derecognised under an entity's previous accounting framework before the date of transition shall not be recognised upon adoption of this FRS. Conversely, for financial assets and liabilities that would have been derecognised under this FRS in a transaction that took place before the date of transition, but that were not derecognised under an entity's previous accounting framework, an entity may choose:

(i) to derecognise them on adoption of this FRS; or

(ii) to continue to recognise them until disposed of or settled.

(b) ***Hedge accounting:***
An entity shall not change its hedge accounting before the date of transition to this FRS for hedging relationships that no longer exist at the date of transition. For hedging relationships that exist at the date of transition, the entity shall follow the hedge accounting requirements of Section 12 *Other Financial Instruments Issues*, including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions of Section 12.

(c) ***Accounting estimates*** (see Example 5).

(d) ***Discontinued operations.***

(e) *Measuring **non-controlling interests***:
The requirements:

(i) to allocate profit or loss and total comprehensive income between non-controlling interest and owners of the parent;

(ii) for accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and

(iii) for accounting for a loss of control over a subsidiary

shall be applied prospectively from the date of transition to this FRS (or from such earlier date as this FRS is applied to restate business combinations).

Optional exemptions

Paragraph 35.10 provides a number of exemptions that entities may elect to use on transition to FRS 102. These aim to ease the requirements for preparation of the balance sheet at the date of transition. Some areas included in these exemptions are:

(a) ***Business combinations including group reconstructions:*** An entity may elect not to restate business combinations that occurred before the transition date. However, if a first-time adopter restates any business combination to comply with FRS 102, it shall restate all later combinations (see Example 2). If a first-time adopter chooses not to apply Section 19 *Business Combinations* retrospectively, the first-time adopter shall recognise and measure all of its assets and liabilities acquired or assumed in a past business combination at the date of transition to FRS 102 in accordance with the requirements of FRS 102, except for goodwill and intangible assets subsumed in goodwill.

If a first-time adopter elects not to apply Section 19 retrospectively, it will still need to apply Section 19 prospectively to any goodwill recognised in its balance sheet at the date of transition. As noted above, the carrying amount of the goodwill would not be adjusted on transition, however it would be amortised over a finite useful life going forward. For an entity that has previously determined a finite useful life for goodwill, the entity can continue to amortise that goodwill over this period so long as it can reliably estimate that useful life. For an entity that has previously determined an indefinite useful life for goodwill, the entity will need to reassess the remaining useful life going forward. If an entity is unable to reliably estimate the useful life of goodwill, then the useful life shall not exceed five years.

(b) ***Share-based payment transactions:*** An entity that has not previously applied FRS 20 *Share-based payments* may elect not to apply FRS 102 to equity instruments that were granted before the date of transition, or to liabilities arising from share-based payment transactions that were settled before the transition date. An entity that has previously applied FRS 20 (IFRS 2) shall apply FRS 20 / IFRS 2 or Section 26 of FRS 102.

(c) ***Fair value as deemed cost:*** An entity may elect for an item of property, plant or equipment, an investment property, or an intangible asset that meets the recognition criteria and the criteria for revaluation, to be measured at its fair value at the date of transition and for that fair value to be used as the deemed cost of the item going forward.

(d) ***Revaluation as deemed cost:*** For a revalued item of property, plant or equipment, investment property, or intangible asset that meets the recognition criteria and the criteria for revaluation, an entity may elect to use as its deemed cost, its revalued amount either at, or before the date of transition (see Example 3).

(e) ***Individual and separate financial statements:*** For investments in subsidiaries, associates and jointly controlled entities, an entity may elect to use the carrying amount at the date of transition determined under its previous GAAP as its deemed cost going forward.

(f) ***Compound financial instruments:*** For compound financial instruments where the liability component is not outstanding at the date of transition, an entity may elect not to separate out the liability and equity components.

(g) ***Service concession arrangements – Accounting by operators:*** An entity may elect not to apply FRS 102 to service concessions arrangements that were entered into before the date of transition. Instead, its previous accounting policies would continue to be applied. A similar exemption is not available to grantors.

(h) ***Arrangements containing a lease:*** An entity may elect to determine whether an arrangement contains a lease based on the facts and circumstances existing at the date of transition, rather than when the arrangement was entered into.

(i) ***Decommissioning liabilities included in the cost of property, plant and equipment:*** An entity may elect to measure the component of the cost of an item of property, plant and equipment resulting from decommissioning liabilities at the date of transition rather than on the date when the obligation initially arose.

(j) ***Dormant companies:*** There is no requirement for dormant companies to restate the opening balance sheet at the date of transition (nor any subsequent balance sheets) until there is a change in its existing balances or the company undertakes any new transactions.

(k) ***Deferred development costs as deemed cost:*** An entity may elect to carry forward the carrying amount of development costs deferred in accordance with SSAP 13 *Research and development* as the deemed cost at that date (see Example 4).

(l) ***Borrowing costs:*** An entity electing to adopt an accounting policy of capitalising borrowing costs may elect to treat the date of transition as the date on which capitalisation of borrowing costs commences (see Example 5).

(m) ***Lease incentives:*** An entity may elect not to apply FRS 102 to lease incentives provided the term of the lease commenced before the date of transition. Instead, the previous accounting treatment would continue to apply.

(n) ***Public benefit entity combinations:*** An entity may elect not to apply FRS 102 to public benefit entity combinations that were effected before the date of transition. However, if a public benefit entity restates any entity combination to comply with this section, it shall restate all later entity combinations.

(o) ***Designation of previously recognised financial instruments:*** An entity may elect to designate previously recognised financial instruments at fair value through profit or loss on the date of transition provided they meet the criteria set out in paragraph 11.14(b) of FRS 102.

Other more specialised exemptions relate to extractive activities and assets and liabilities of subsidiaries (associates and joint ventures) where transition dates may differ from the parent (entity with significant influence and venturer).

Examples

Examples 1 to 5 in this Education Note relate to Entity T which has a 31 December 2015 year end and is preparing its first set of financial statements compliant with FRS 102. Its date of transition to FRS 102 is 1 January 2014.

Example 1
Accounting estimates

At 31 December 2013, Entity T had a significant debtor balance of CU500. Entity T was concerned about the credit risk of the debtor and was in discussion with the customer as to how the debt might be settled. As a consequence Entity T had made a provision of CU250, ie for 50 per cent of the balance.

During 2014, the debtor collapsed and is currently being liquidated. As a consequence Entity T does not think it will collect any of the outstanding debt.

Although Entity T is preparing an opening balance sheet at the date of transition as at 1 January 2014, hindsight shows that its accounting estimate made on 31 December 2013 was inaccurate[1], however it does not make a transitional adjustment as paragraph 35.9(c) of FRS 102 prohibits retrospective adjustments to correct accounting estimates.

Example 2
Business combination before the date of transition

On 1 January 2010, Entity T acquired a wholly owned subsidiary and applied the requirements of FRS 6 *Acquisitions and Mergers* and FRS 7 *Fair Values in Acquisition Accounting*. In accordance with these FRSs, Entity T recognised the following opening fair values in its consolidated financial statements:

[1] It is also possible that the amount of provision that would have been recognised in accordance with FRS 102 would have differed, not only because of the effect of hindsight, but because the requirements of FRS 102 paragraphs 11.21 to 11.25 could have led to a different value for the impairment loss to be recognised (based on the information available at 31 December 2013).

	CU	CU
Property, plant and equipment	30,000	
Goodwill	10,000	
		40,000
Stock	1,000	
Debtors	1,500	
Net current assets	2,500	
Creditors	(3,000)	
Net current liabilities		(500)
Net assets acquired at fair value		39,500

On transition (1 January 2014): Goodwill

Paragraph 19.23(a) of FRS 102 states that goodwill shall be considered to have a finite useful life and if an entity is unable to make a reliable estimate of the useful life, the life shall not exceed five years.

On acquisition in 2010, Entity T decided that in accordance with FRS 10 *Goodwill and intangible assets* the goodwill had an economic life of 10 years. At 31 December 2013 the carrying amount for the goodwill is therefore CU6,000[2] and has a remaining useful life of 6 years.

Entity T considers there is evidence to support the remaining economic life of 6 years and provides adequate evidence to support this. It is therefore not required to adjust the expected amortisation profile.

Fair values at acquisition

As the acquisition occurred prior to the date of transition, Entity T elects not to apply FRS 102 to this acquisition (in accordance with paragraph 35.10(a)). Entity T therefore does not review the acquired identifiable assets and liabilities, either to determine whether additional items would have been recognised if FRS 102 had been applicable at the date of acquisition, or to restate their fair values at that date if application of FRS 102 would have required recognition at a different value. However, Entity T does need to consider whether assets and liabilities acquired in the business combination which are still held on the date of transition, are recognised and measured in accordance with FRS 102 going forward.

[2] Being CU10,000 x 6/10 years

Example 3
Revaluation as deemed cost

Entity T has two properties, A and B. Neither Property A nor Property B is an investment property. Entity T has an accounting policy to revalue its properties and to depreciate them over a useful life of 50 years.

Property A was acquired on 31 December 1980 at a cost of CU1,000 and has been revalued on a regular basis; the last time was on 31 December 2010 where its value was recorded in the financial statements at CU100,000 and its remaining useful life was 20 years. There has been no significant change in the value of Property A since that revaluation.

Property B was acquired on 31 December 2010, at a cost of CU50,000. Property B has never been revalued as it was purchased in the year of the most recent valuation and its cost was the best available evidence of its valuation. There has been no impairment in its value.

On transition (1 January 2014):
Property A

If Entity T decides not to continue its policy of revaluation, it has a choice in relation to Property A:

a) it could elect to use the most recent revaluation in 2010 (being CU100,000) as its deemed cost at that date and no further adjustment is required; or
b) it could restate the property to its original cost of CU1,000.

If the revalued amount of CU100,000 were used as its deemed cost, in order to comply with company law the revaluation reserve would be retained and the excess depreciation would continue to be offset against it.

If the property is restated to the original cost of CU1,000 the following adjustment would be required:

Dr	Revaluation Reserve	CU84,660
Dr	Accumulated depreciation	CU14,340[3]
Cr	Property, plant and equipment	CU99,000

Property B

No adjustment is required on transition for Property B[4].

3 This represents three years depreciation (from 31 December 2010 to 1 January 2014) on the revalued amount being £15,000 in total (CU100,000 x 3 / 20 years remaining) less 33 years depreciation (from 31 Dec 1980 to 1 January 2014) on the historical cost being CU660 in total (CU1,000 x 33 / 50 years) which is not adjusted for.

4 The exemption to permit revaluation as deemed cost is available at the level of individual items of property, plant and equipment. Entity T could choose to revalue Property B at the date of transition and use that new valuation as deemed cost. Similarly, as an alternative to using the 2010 valuation for Property A, Entity T could revalue it at the transition date (irrespective of whether Property B is revalued at transition date).

Example 4
Carrying value of development costs

Entity T had previously made an accounting policy choice to capitalise development costs meeting the criteria set out in SSAP 13 *Accounting for research and development*[5].

In 2010 Entity T undertook a programme to develop the products it acquired as part of the acquisition in Example 1 to be compatible with its own products. In accordance with SSAP 13, it capitalised CU2,500 of expenditure which it is amortising over five years. Four years later at 31 December 2013, the carrying amount of asset was therefore CU500.

Paragraph 18.8H of FRS 102 permits an entity to recognise an intangible asset arising from the development phase of an internal project providing it meets certain criteria. Entity T makes the accounting policy choice to capitalise development costs meeting the criteria set out in FRS 102.

Entity T may elect to take the carrying amount of those development costs deferred in accordance with SSAP 13 at the date of transition, to be the deemed cost going forward. Therefore, although in this example it is unlikely that there is a material difference between the carrying value of the development costs measured using SSAP 13 or FRS 102, for ease Entity T elects to retain the value determined in accordance with SSAP 13 as the deemed cost of deferred development costs and makes no adjustment to its balance sheet at the date of transition.

Example 5
Borrowing costs

Entity T decided to construct a new building for its own use. Work on the construction commenced during 2013. Entity T capitalises tangible fixed assets on the basis of cost, in accordance with FRS 15 *Tangible Fixed Assets*, but had not previously constructed any significant assets and therefore its accounting policy did not include the capitalisation of finance costs.

As at 31 December 2013, Entity T had capitalised construction costs of CU25,000 and estimated that it still had approximately nine months of construction work ahead. Had Entity T had a policy of capitalisation, finance costs that could have been capitalised amounted to CU300.

During 2014 Entity T completes construction of the building. The total cost to be capitalised in accordance with FRS 102 (excluding borrowing costs) is CU90,000. Qualifying borrowing costs calculated in accordance with FRS 102 relating to the project as a whole are CU2,500.

On transition to FRS 102, Entity T reviews its accounting policies and decides that it will now elect to capitalise borrowing costs in accordance with Section 25 *Borrowing Costs* of FRS 102, and in accordance with paragraph 35.10(o) it elects to capitalise costs prospectively from 1 January 2014. As a result, no adjustment is made to the balance sheet at the date of transition (ie 1 January 2014); the CU300 previously written off is not capitalised, but CU2,200[6] of borrowing costs are capitalised during the year ended 31 December 2014.

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5 Research expenditure must be expensed as incurred (SSAP 13 paragraph 24), but SSAP 13 permits a choice of accounting policy for development expenditure meeting certain criteria. Development expenditure may be written off as incurred, or deferred to future periods and amortised (SSAP 13 paragraphs 25 to 28).

6 The amount capitalised is £2,200 = £2,500 (total qualifying borrowing costs) - £300 (borrowing costs incurred prior to 1 January 2014 and elected not to be capitalised).

Required transitional disclosures

Explanation of transition to FRS 102

Paragraph 35.12 states that an entity shall explain how the transition from its previous financial reporting framework to this FRS affected its reported financial position, financial performance.

Example 6
Disclosure of transition to FRS 102

These financial statements for the year ended 31 December 2015 are the first financial statements of [name] that comply with FRS 102. The date of transition to FRS 102 is 1 January 2014.

The transition to FRS 102 has resulted in a small number of changes in accounting policies compared to those used previously.

The following notes to the financial statements describe the differences between equity and profit or loss presented previously, and the amounts as restated to comply with the accounting policies selected in accordance with FRS 102 for the reporting period ended at 31 December 2014 (ie comparative information), as well as equity presented in the opening statement of financial position (ie at 1 January 2014). It also describes all the required changes in accounting policies made on first-time adoption of FRS 102.

Reconciliations of equity and profit or loss

Paragraph 35.13 states that to comply with the above an entity's first financial statements prepared using this FRS shall include:

(a) a description of the nature of each change in accounting policy.

(b) reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this FRS for both of the following dates:

  (i) the date of transition to this FRS; and

  (ii) the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework.

(c) a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with this FRS for the same period.

Paragraph 35.14 states that if an entity becomes aware of errors made under its previous financial reporting framework, the reconciliations required shall, to the extent practicable, distinguish the correction of those errors from changes in accounting policies.

FRS 102 does not specify the format of the reconciliations of equity and profit or loss. Set out below are suggested formats for the reconciliations, and entities will need to determine the most suitable format for their reconciliations taking into account the nature and amount of their own adjustments.

Reconciliations
Suggested Option 1

Reconciliation of equity

		At 1 Jan 2014			At 31 Dec 2014		
	Note	As previously stated	Effect of transition	FRS 102 (as restated)	As previously stated	Effect of transition	FRS 102 (as restated)
		CU '000	CU '000	CU '000	CU '000	CU '000	CU '000
Fixed assets		5,868	-	5,868	5,416	-	5,416
Current assets	(i) (ii)	2,475	15	2,490	2,520	17[a]	2,537
Creditors: amounts falling due within one year	(i) (iii)	(2,355)	(16) [b]	(2,371)	(1,824)	(20) [c]	(1,844)
Net current assets		120	(1)	119	696	(3)	693
Total assets less current liabilities		5,988	(1)	5,987	6,112	(3)	6,109
Creditors: amounts falling due after more than one year	(i)	(2,900)	(6)	(2,906)	(2,840)	(3)	(2,843)
Provisions for liabilities		(410)	-	(410)	(465)	-	(465)
Net assets		2,678	(7)	2,671	2,807	(6)	2,801
Capital and reserves		2,678	(7)	2,671	2,807	(6)	2,801

Reconciliation of profit or loss for the year

		Year ended 31 Dec 2014		
	Note	As previously stated	Effect of transition	FRS 102 (as restated)
		CU '000	CU '000	CU '000
Turnover		832	-	832
Cost of sales	(i) (ii)	(520)	1[d]	(519)
Gross profit		312	1	313
Administrative expenses	(i) (ii) (iii)	(65)	0[e]	(65)
Other operating income		42	-	42
Operating profit		289	1	290
Interest receivable and similar income		5	-	5
Interest payable and similar charges		(130)	-	(130)
Taxation		(35)	-	(35)
Profit on ordinary activities after taxation and for the financial year		129	1	130

Reconciliations
Suggested Option 2

Reconciliation of equity

	Note	At 1 Jan 2014	At 31 Dec 2014
		CU '000	CU '000
Capital and reserves (as previously stated)		2,678	2,807
Recognition of derivative financial instruments	(i)	(2)	1
Re-measurement of stock using spot exchange rate	(ii)	-	(1)
Short-term compensated absences	(iii)	(5)	(6)
Capital and reserves (as restated)		2,671	2,801

Reconciliation of profit or loss for the year

	Note	Year ended 31 Dec 2014
		CU '000
Profit for the year (as previously stated)		129
Recognition of derivative financial instruments	(i)	3
Re-measurement of stock using spot exchange rate	(ii)	(1)
Short-term compensated absences	(iii)	(1)
Profit for the year (as restated)		130

Notes to the reconciliations

The following notes are applicable to both formats set out above.

Financial instruments

(i) [Name] was not previously required to recognise derivative financial instruments on the balance sheet. Instead the effects of the derivative financial instruments were recognised in profit or loss when the instruments were settled. Derivative financial instruments are classified as 'other financial instruments' in FRS 102 and are recognised as a financial asset or a financial liability, at fair value, when an entity becomes party to the contractual provisions of the instrument. Consequently financial assets of CU15,000 and financial liabilities of CU17,000 have been recognised in the opening balance sheet at 1 January 2014. Financial assets of CU18,000 and financial liabilities of CU17,000 have been recognised in the balance sheet as at 31 December 2014. Derivatives are measured to fair value with gains (losses) from changes in fair value recognised in profit or loss. The effect on profit for the year ended 31 December 2014 is an increase of CU3,000.

(ii) The derivative financial instruments are foreign exchange forward contracts. In applying SSAP 20 *Foreign currency translation*, [Name] previously chose to translate purchases in foreign currencies at the rate of exchange specified in a matching forward contract. This is not permitted by FRS 102, which requires purchases to be translated using the spot exchange rate on the date of the transaction. FRS 102 does not provide an exemption from measuring stock bought in a foreign currency and paid for before the transition date in accordance with its required accounting policies, but the difference is not material and accordingly no adjustment has been made. Items purchased since the transition date have been re-measured based on spot exchange rate. Consequently stock at 31 December 2014 has been reduced and cost of sales for the year end has been increased by CU1,000 and costs of CU2,000 have been reclassified as administrative expenses rather than cost of sales.

Short-term compensated absences

(iii) Prior to applying FRS 102, [Name] did not make provision for holiday pay (ie holiday earned but not taken prior to the year-end). FRS 102 requires the cost of short-term compensated absences to be recognised when employees render the service that increases their entitlement. Consequently an additional accrual of CU5,000 at 1 January 2014 has been made to reflect this. The additional provision at 31 December 2014 is CU6,000 and the effect on profit for the year ended 31 December 2014 is an additional expense of CU1,000.

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[a] Made up of financial assets of CU18,000 (Note i) and the decrease in stock of CU1,000 (Note ii).

[b] Made up of financial liabilities of CU17,000 (Note i) less creditors amounts falling due after more than one year of CU6,000 plus the holiday pay accrual of CU5,000 (Note iii).

[c] Made up of financial liabilities of CU17,000 (Note i) less creditors amounts falling due after more than one year of CU3,000 plus the holiday pay accrual of CU6,000 (Note iii).

[d] Made up of an increase of CU1,000 (Note ii) less the reclassification of CU2,000 to administrative expenses (Note ii) giving an overall reduction in cost of sales of CU1,000.

[e] Made up of a profit (ie a reduction in administrative expenses) from the recognition of the derivatives of CU3,000 (Note i), an increase from the reclassification of CU2,000 (Note ii) and an increase in the holiday pay accrual of CU1,000 (Note iii) giving an overall nil effect.