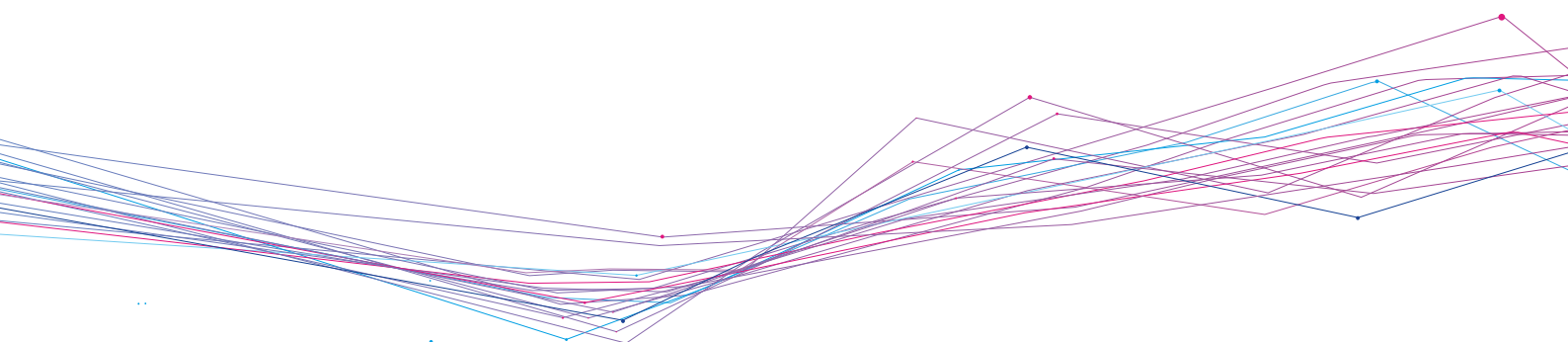




KEY DIFFERENCES
BETWEEN
UK GAAP AND IFRS

CONTENT

1 Introduction	03
2 Key Differences between FRS 102 and IFRS	04
2.1 Statement of Financial Position	04
2.1.1 Intangible Assets	04
2.1.2 Property, Plant and Equipment	06
2.1.3 Investment Property	08
2.1.4 Financial Instruments	09
2.1.5 Deferred Taxes	12
2.2 Statement of Comprehensive Income	13
2.2.1 Revenue Recognition	13
2.2.2 Borrowing Costs	15
3 Summary	16
4 Sources	17



1 INTRODUCTION

Companies with securities admitted to trading on a regulated market are required to prepare their consolidated financial statements in accordance with IFRS. All other groups and companies in the UK have the choice to follow either IFRS or UK GAAP. With effect from January 1, 2015, financial reporting standards in the United Kingdom and Republic of Ireland were fundamentally revised, replacing the existing standards with five new Financial Reporting Standards (FRS) which are commonly referred to as new UK GAAP:

- FRS 100 *Application of Financial Reporting Requirements*
- FRS 101 *Reduced Disclosure Framework*
- FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*
- FRS 103 *Insurance Contracts*
- FRS 104 *Interim Financial Reporting*

The overall goal of this new set of FRS is to provide users of financial statements with high-quality understandable financial information, proportionate to the size and complexity of the entity and users' information needs. FRS 102 is the core of the new standards and generally based on the IASB's IFRS for SMEs (International Financial Reporting Standard for Small and Medium-sized Entities). This standard takes into consideration that users of private entity financial statements have different information needs than users of listed entities and reduces the costs and difficulty to prepare financial statements for private entities. This white paper gives an overview of key differences between accounting policies under FRS 102 and full IFRS and should not be interpreted as exhaustive list. In each section, the respective accounting policy is first described under FRS 102 and then compared to the corresponding rules under IFRS.



2 KEY DIFFERENCES BETWEEN FRS 102 AND IFRS

2.1 STATEMENT OF FINANCIAL POSITION

2.1.1 INTANGIBLE ASSETS

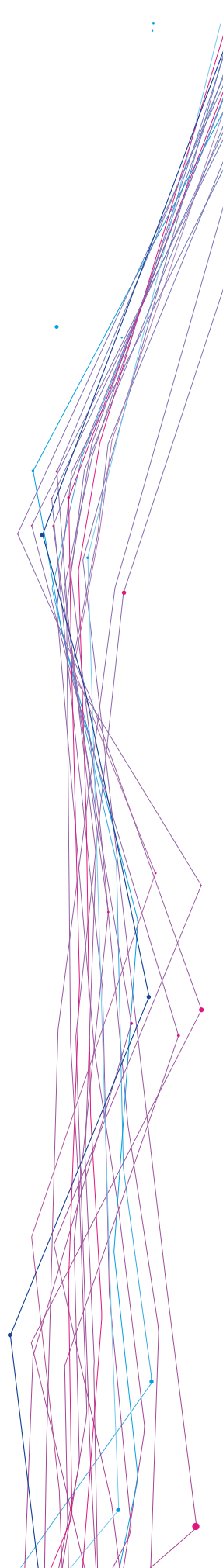
Development Costs

According to FRS 102, Section 18.8H, an entity **may** recognize an intangible asset arising from development, if six specific criteria are met. An entity has to demonstrate the technical feasibility of completing the intangible asset (1), its intention to complete the asset and use or sell it (2) as well as its ability to use or sell it (3). In addition, an entity must provide evidence that the intangible asset will generate future economic benefits (4), demonstrate the availability of resources to complete the asset and use or sell it (5), and the ability to measure reliably the expenditure relating to the development (6). If the criteria are not cumulatively met, development costs are expensed as incurred. Expenditure on research or the research phase of an internal project is always recognized as an expense when incurred (Section 18.8E).

On the contrary, IAS 38 *Intangible assets* **requires** entities to capitalize development costs if all six criteria in IAS 38.57 (which are identical to the ones in FRS 102) are met. Thus, there is no accounting choice between capitalizing and expensing such costs under IFRS. Like FRS 102, research costs are expensed as incurred (IAS 38.54). IAS 38 also states that an intangible asset has to meet two more criteria: (1) It's probable that future economic benefit from the asset will flow through the entity, (2) the cost of the asset can be measured reliably.



© Andrew Brookes/
Cultura/Getty Images



Useful life

Under FRS 102, Section 18.19, all intangible assets are considered to have a finite useful life. If an entity is unable to make a reliable estimate of the useful life, the life shall not exceed 10 years.

According to IAS 38.88, an entity has to determine whether the useful life of an intangible asset is finite or indefinite. If the useful life is finite, the intangible asset is amortized over its useful life. In case of an indefinite useful life, i.e. there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows, the intangible asset shall not be amortized. In accordance with IAS 36 *Impairment of Assets*, an entity must test intangible assets with indefinite useful life for impairment in each period.

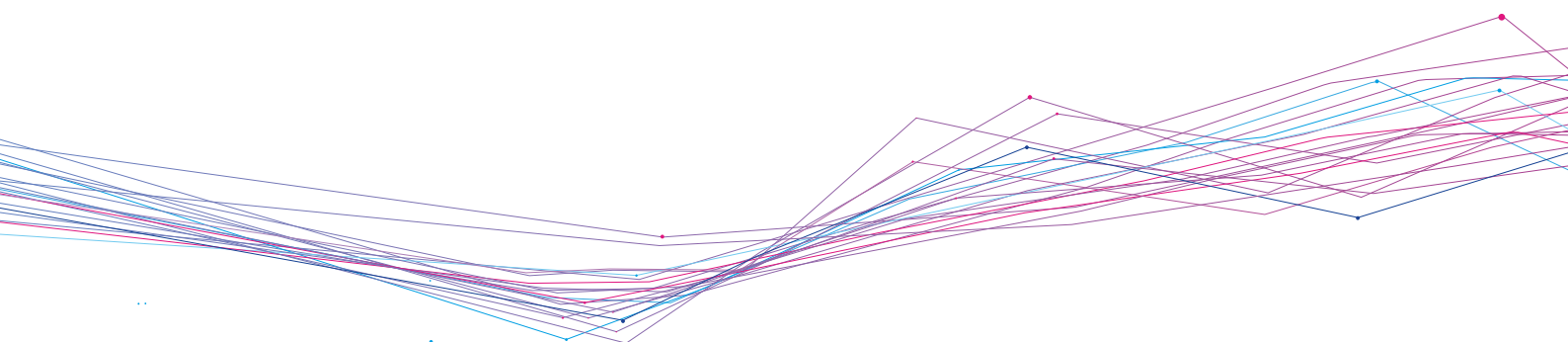
Goodwill

Goodwill resulting from a business combination shall be recognized as an asset (Section 19.22(a)) and measured at cost less accumulated amortization and accumulated impairment losses (Section 19.23).

Initially, goodwill is measured as excess of the cost of the business combination over the acquirer's share of the fair value of the identifiable assets and liabilities (Section 19.22(b)).

The useful life of goodwill is also considered to be finite and thus has to be estimated by the entity. Like other intangible assets, the useful life shall not exceed 10 years, if a reliable estimate cannot be made. Furthermore, an entity shall follow the rules in Section 27 *Impairment of Assets* for testing goodwill for impairment. Goodwill is allocated to cash-generating units and tested for impairment only when an impairment indicator exists. Negative goodwill (gain on bargain purchase) is measured on the statement of financial position along with goodwill under FRS102.

Under IFRS, the full goodwill method is an option for initial recognition, i.e. there is the option to measure non-controlling interests at fair value (IFRS 3.19(a)). Regarding subsequent measurement, goodwill is not amortized on a systematic basis, but measured at the amount recognized at the acquisition date less any accumulated impairment losses (IAS 36.B63). Like other intangible assets with indefinite useful life, goodwill has to be tested for impairment annually (IAS 36.96). Under IFRS Negative goodwill is presented as gain on bargain purchase on the Profit or Loss statement.



2.1.2 PROPERTY, PLANT AND EQUIPMENT

Leases

Under FRS 102, leases are categorized into finance and operating leases. According to Section 20.4, a lease is classified as a finance lease if all the risks and rewards incidental to ownership of the asset are transferred from the lessor to the lessee. If risks and rewards of ownership remain with the lessor, the lease is classified as an operating lease. The classification of a lease depends on the economic substance of the transaction rather than the form of the contract. As guidance on the classification of leases, FRS 102 provides examples (Section 20.5) and indicators (Section 20.6) which normally lead to a lease being classified as a finance lease.

In case of a finance lease, the lessee shall recognize the underlying asset and the liability from future lease payments in its statement of financial position. The amounts shall equal the fair value of the underlying asset, or if lower, the present value of the minimum lease payments, determined at the inception of the lease. Any initial direct costs relating to the lease incurred by the lessee are added to the amount recognized as an asset (Section 20.9).

Operating leases, though, do not have an impact on the statement of financial position. According to Section 20.15, lease payments from operating leases are expensed over the lease term on a straight-line basis or, if appropriate, on another systematic basis.



IFRS 16 *Leases* on the other hand does not differentiate between finance and operating leases for the lessee. If a contract meets the definition of a lease, lessees have to follow a uniform accounting model and have to recognize a right-of-use asset and a lease liability (comparable to a finance lease under FRS 102) from the lease in the statement of financial position (IFRS 16.22). The asset is subject to depreciation, whereas the liability is accounted for using the effective interest method.

A lessee **may** elect not to apply the general requirements for recognition and measurement to short-term leases (leases with a term of one year or less) and leases for which the underlying asset is low of value (e.g. computers, mobile phones, tablets, etc.). In these cases, an entity may choose to recognize lease payments as an expense in the statement of profit or loss on either a straight-line basis or another systematic basis (IFRS 16.6). This treatment is identical to an operating lease under FRS 102.

In addition to the new accounting model, IFRS 16 introduces revised rules for sale-and-leaseback transactions and requires extensive disclosures.

For the lessor, however, the differentiation between operating and finance leases still exists and there are no material differences regarding lessor accounting between FRS 102 and IFRS 16.

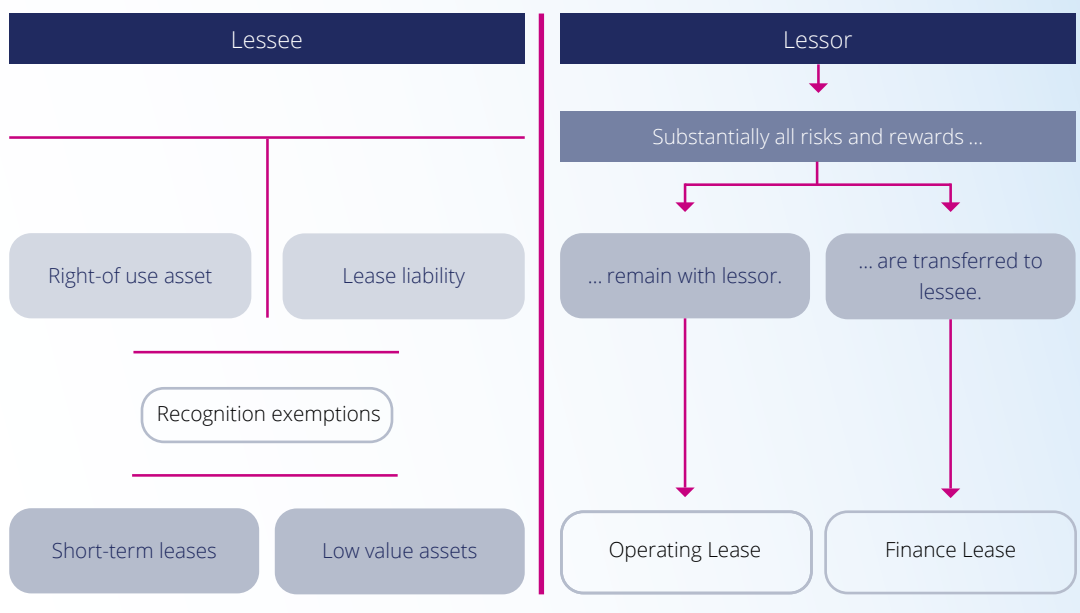


Fig. 1: Accounting model according to IFRS 16

2.1.3 INVESTMENT PROPERTY

Under FRS 102, investment property shall be initially measured at cost. Cost also include directly attributable expenditure, such as legal and brokerage fees or property transfer taxes (Section 16.5). Subsequently, investment property shall be measured at fair value, with changes in fair value recognized in profit or loss.

According to IAS 40, *Investment property* is also measured initially at cost, including directly attributable expenditure, or through subsequent measurement. However, It should be noted that IAS 40 allows for the choice of accounting method, the fair value model with changes in fair value recognized in profit or loss, or the cost model. Under the cost model, investment property is carried at cost less any accumulated depreciation and impairment losses. IAS 40 refers to the specific rules in IAS 16 *Property, plant and equipment*, IFRS 16 *Leases* (in case a right-of-use asset meets the definition of investment property), and IFRS 5 *Non-current assets held for sale and discontinued operations* for the application of the cost model.



2.1.4 FINANCIAL INSTRUMENTS

FRS 102 contains two sections that apply to financial instruments. Section 11 applies to basic financial instruments, whereas Section 12 applies to other, more complex financial instruments and transactions. Both Section 11.2 and 12.2 allow an entity to choose out of three options regarding recognition and measurement of financial instruments:

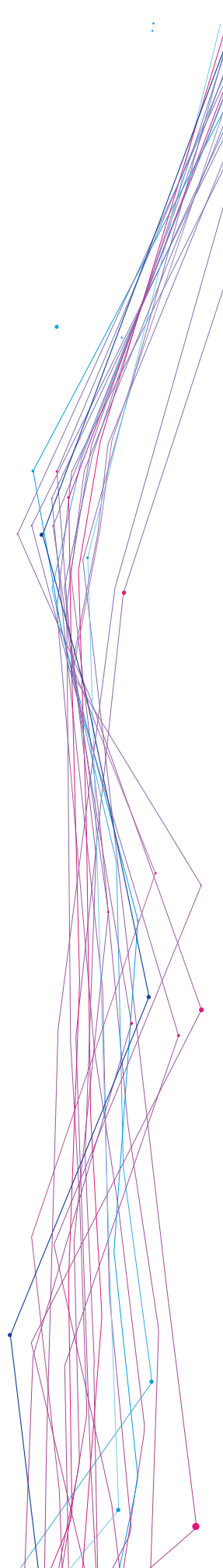
- a. An entity can apply the provisions of both Section 11 and 12 in full; or
- b. An entity can apply the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement* and the presentation and disclosure provisions of Section 11 and 12; or
- c. An entity can apply the recognition and measurement provisions of IFRS 9 *Financial Instruments* and presentation and disclosure requirements of Section 11 and 12.

IFRS 9 became effective for financial years commencing on or after January 1, 2018 and largely replaced the provisions of IAS 39. If an entity decides for the provisions of IAS 39, it shall apply the version which applied immediately prior to IFRS 9 superseding IAS 39.

According to Section 11.8, cash, certain debt instruments (such as a loans receivable or payable), and investments in non-derivatives (e.g. ordinary shares) are typically classified as basic financial instruments. These instruments are initially measured at the transaction price (adjusted for transaction costs) and subsequently measured using the effective interest method. At the end of each reporting period, it must be assessed if there is objective evidence for an impairment of any financial asset (Section 11.21). Section 11.22 lists indicators for objective evidence that a financial asset is impaired.

Section 11.6 gives examples of financial instruments which are generally within the scope of Section 12, e.g. derivatives, asset-back-securities or financial instruments that qualify as hedging instruments. Such financial instruments are generally measured at fair value at profit or loss (FVTPL), except for instruments stated in Section 12.8.

Regarding hedge accounting, FRS 102 distinguishes between fair value hedges, cash flow hedges, and hedges of a net investment in a foreign operation. In fair value hedges, the hedged item and the hedging instrument are both measured at FVTPL; thus, in a fully effective fair value hedge, gains and losses on the hedging instrument and the hedged item will exactly offset each other in profit or loss. In cash flow hedges and hedges of a net investment in a foreign operation, the hedged item is subject to the regular accounting rules, whereas the effective portion of changes of fair value of the hedging instrument is recognized in other comprehensive income. The ineffective portion of changes in fair value is recognized in profit or loss.



IAS 39 distinguishes between four categories of financial assets and two categories of financial liabilities, with each having their own recognition and measurement rules. Financial assets can be classified as:

- Financial assets at fair value through profit or loss (held for trading)
- Available-for-sale financial assets (measured at fair value through OCI (FVOCI))
- Loans and receivables (measured at amortized cost (AC))
- Held-to-maturity investments (measured at AC)

Financial liabilities are classified as either:

- Financial liabilities at FVTPL; or
- Financial liabilities measured at AC using the effective interest method

According to IFRS 9, financial assets are measured at AC, at FVTPL or at FVTOCI depending on the contractual cash flows and the business model that they are managed under. For non-trading instruments there is an irrevocable accounting choice to measure them at FVTOCI at initial recognition.

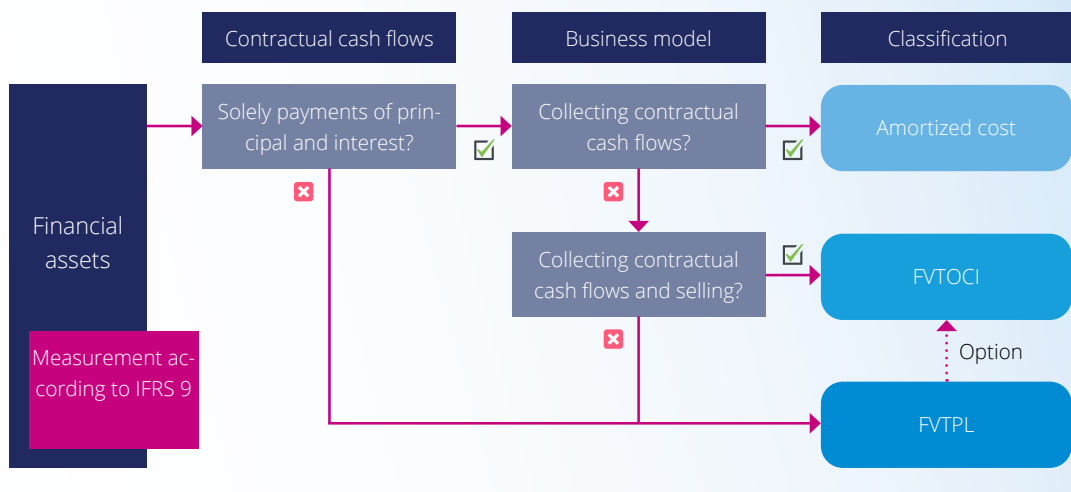


Fig. 2: Classification and measurement of financial assets according to IFRS 9

Financial liabilities are generally measured at AC, except for the exceptions stated in IFRS 9.4.2.1.

Even though the classification differs conceptually between FRS 102, IAS 39, and IFRS 9, for non-financial corporations the classification and thus the accounting treatment regarding initial and subsequent measurement will often be the same under all three standards.

With respect to the impairment model, there are significant differences between IFRS 9 and the other two standards. Both FRS 102 and IAS 39 follow the so-called incurred loss model, i.e. an impairment loss is only recognized when there is objective evidence that a financial asset is impaired. Both standards provide indicators for such objective evidence. On the contrary, IFRS 9 introduces the so-called expected loss model. Under this model, the allowance for losses is based on expected cash shortfalls in the future. IFRS 9 establishes three different approaches for this impairment model (the general approach, a simplified approach for certain financial assets like trade receivables, and a credit-adjusted approach for loans which are impaired at initial recognition). The three approaches are not discussed in detail in this white paper; however, all other things equal impairment losses are higher under IFRS 9 compared to the other standards due to the consideration of future expected credit losses.

IFRS 9 also distinguishes between fair value hedges, cash flow hedges, and hedges of a net investment in a foreign operation and does not change the accounting rules for these hedges. However, IFRS 9 provides new criteria for applying hedge accounting which are more aligned with the way entities manage their risks.



2.1.5 DEFERRED TAXES

According to FRS 102, Section 29.6, deferred taxes shall be recognized in respect of all **timing differences** at the reporting date. Timing differences are differences between taxable profits and total comprehensive income. Such differences arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognized in financial statements. Examples for common timing differences include capital allowances which differ from depreciation expense for the period or provisions recognized in one period in the financial statements which are tax-deductible only when the related expenditure is incurred.

However, according to IAS 12 *Income taxes*, deferred taxes shall be recognized using the **temporary concept** which is based on the statement of financial position. IAS 12.5 defines temporary differences as differences between the carrying amount of an asset or liability in the statement of financial position and its tax base which is the amount attributed to an item for tax purposes. According to IAS 12.15 and IAS 12.24, deferred tax assets and deferred tax liabilities are generally recognized for all temporary differences (with some exceptions regarding the initial recognition of certain assets and liabilities, such as goodwill).

Permanent differences do generally not give rise to deferred taxes, regardless of which approach is applied.



2.2 STATEMENT OF COMPREHENSIVE INCOME

2.2.1 REVENUE RECOGNITION

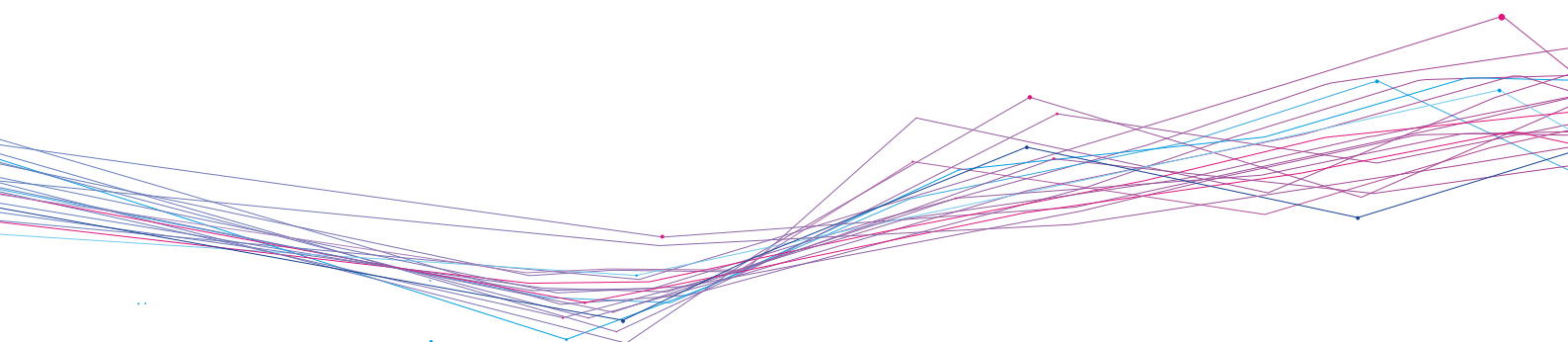
FRS 102, Section 23.1, defines various categories for revenue. Revenue may arise from the sale of goods, the rendering of services, construction contracts or the use of the entity's assets by others (interest, royalties or dividends). Revenue from leases is explicitly excluded from the scope of Section 23. An entity shall measure revenue at the fair value of the consideration received or receivable (Section 23.3). With respect to the timing of revenue recognition, Section 23 differentiates between the four categories of revenue.

Revenue from the sale of goods is generally recognized at the point in time when the significant risks and rewards of ownership are transferred to the buyer (Section 23.10(a)).

Revenue from services and construction contracts is recognized according to the stage of completion at the end of the reporting period (Section 23.14/Section 23.17). FRS 102 suggests possible methods for determining the stage of completion (Section 23.22); the cost-to-cost method is the one most commonly used in practice.

Interest shall be recognized using the effective interest method, royalties shall be recognized on an accrual basis in accordance with the substance of the relevant agreement, and dividends shall be recognized once the shareholder's right to receive payment is established (Section 23.29).

IFRS 15 *Revenue from contracts with customers* follows a different approach for revenue recognition. There is no differentiation regarding revenue recognition for different categories; revenue is generally recognized when an entity transfers control of an asset (i.e. a good or service) to a customer (IFRS 15.31). Thus, IFRS 15 is based on a control approach, whereas FRS 102 is based on a risks-and-rewards approach.



Furthermore, IFRS 15 introduces a five-step model for revenue recognition which is applicable for all contracts with customers:

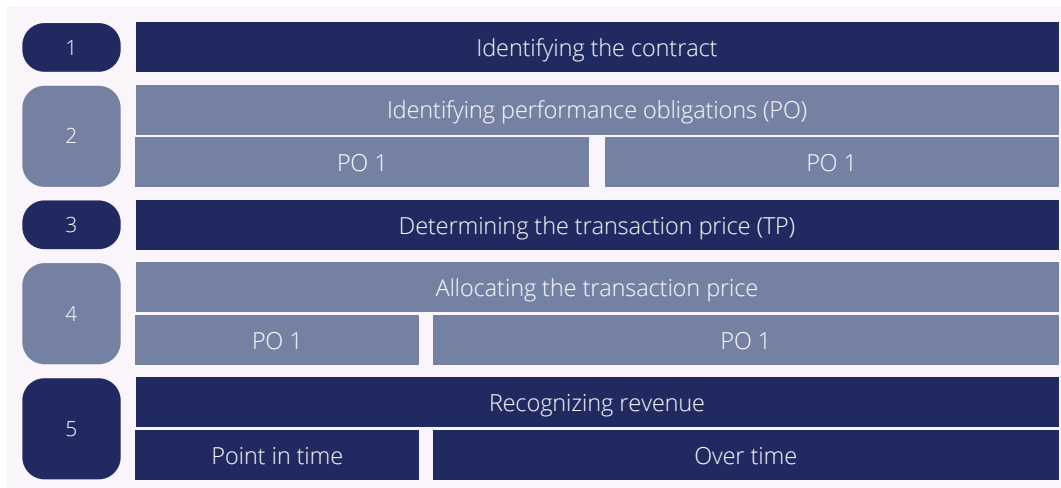


Fig. 3: The five-step model according to IFRS 15

At first, an entity must assess whether a contract is in the scope of IFRS 15. Therefore, a contract has to meet the criteria set out in IFRS 15.9 (e.g. each party's rights must be identifiable and it is probable that the entity will collect the consideration from the customer).

Second, the performance obligations in the contract have to be identified. A good or a service in a contract is a separate performance obligation, if the customer can benefit from it and it is not highly interrelated with other goods and services in the contract. For instance, if a machine is sold together with a regular maintenance service, both the transfer of the machine and the service each represent one performance obligation in the contract.

In step 3, the total transaction price, i.e. the consideration to be received from the customer, must be determined. Therefore, certain aspects, like variable consideration or financing components, have to be considered.

In step 4, the total transaction price is allocated to all performance obligations identified in step 2. This allocation is performed on the basis of their relative stand-alone selling prices. These have to be estimated, if they are not directly observable. This allocation of the transaction price may lead to significant differences between the amount billed and the revenue recognized for a good or service.

Finally, revenue from each performance obligation is recognized either at a point in time or over time. Revenue is recognized over time, if one of the criteria in IFRS 15.35 is met (for instance, revenue from services is generally recognized over time). If revenue is recognized over time, IFRS 15 suggests multiple methods how to determine the stage of completion. Comparable to FRS 102, output methods (e.g. surveys of work completed) or input methods (e.g. cost-to-cost method) may be appropriate. However, the criteria in IFRS 15 when to recognize revenue may lead to material timing differences between IFRS 15 and FRS 102.

2.2.2 BORROWING COSTS

According to FRS 102, Section 25.2, an entity has an accounting choice regarding the recognition of borrowing costs. It **may** capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Qualifying assets are non-financial assets which necessarily take a substantial period of time to get ready for their intended use or sale (e.g. manufacturing plants, inventories, intangible assets).

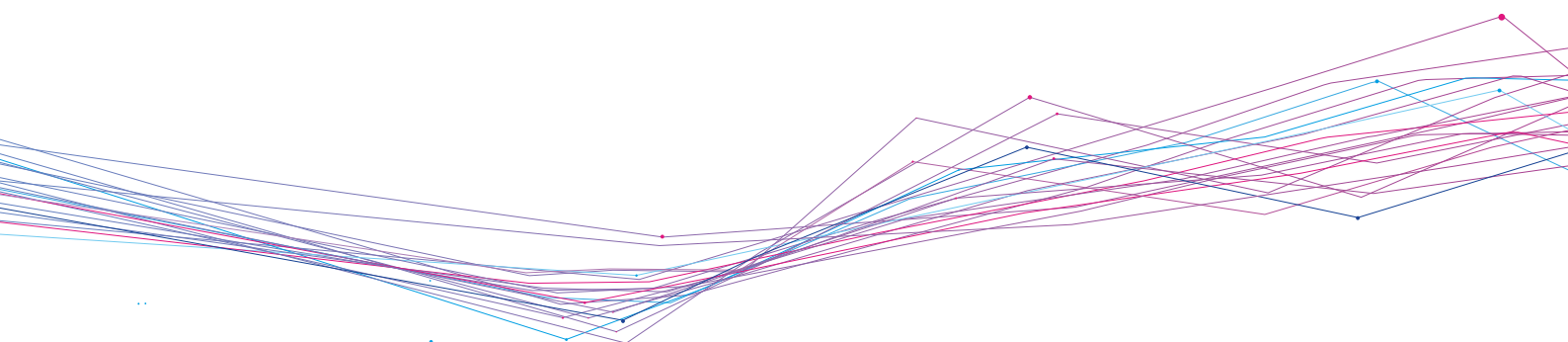
If the entity chooses not to capitalize the borrowing costs, it has to recognize them as an expense in the statement of profit or loss in the period in which they are incurred (Section 25.2).

On the contrary, IAS 23.8 **requires** entities to capitalize borrowing costs for a qualifying asset. The definition of a qualifying asset is identical under IFRS and UK GAAP. Other borrowing costs shall be recognized as expenses in the period in which they are incurred.



3 SUMMARY

Topics	UK GAAP	IFRS
Financial instruments	<ul style="list-style-type: none"> Choice between the provisions of FRS 102, IAS 39 or IFRS 9 	<ul style="list-style-type: none"> Only IFRS 9 is applicable
Revenue recognition	<ul style="list-style-type: none"> Risks-and-rewards approach 	<ul style="list-style-type: none"> Control approach Five-step model to be applied
Leases	<ul style="list-style-type: none"> Differentiation between operating and finance leases Only leases classified as finance leases impact the balance sheet, whereas operating leases are treated completely off-balance sheet. 	<ul style="list-style-type: none"> No differentiation between operating and finance leases for the lessee All leases generally lead to the recognition of a right-of-use asset and a lease liability in the balance sheet.
Investment property	<ul style="list-style-type: none"> Measured at fair value, with changes in fair value recognized in profit or loss 	<ul style="list-style-type: none"> Accounting choice between the fair value model and the cost model
Intangible assets	<ul style="list-style-type: none"> May capitalize development costs if certain criteria are met Finite useful life and thus subject to amortization Partial goodwill method Goodwill is considered to have a finite life and is subject to amortization. 	<ul style="list-style-type: none"> Must capitalize development costs if certain criteria are met Determination of useful life as finite or indefinite Accounting choice between partial goodwill method and full goodwill method Goodwill is considered to have an indefinite life and is subject to an annual impairment test.
Deferred taxes	<ul style="list-style-type: none"> Timing concept 	<ul style="list-style-type: none"> Temporary concept
Borrowing costs	<ul style="list-style-type: none"> May be capitalized for a qualifying asset 	<ul style="list-style-type: none"> Have to be capitalized for a qualifying asset



4 SOURCES

BDO (2013): FRS 102 – What it means to you and where to next.

<https://michaelfarrellonline.files.wordpress.com/2014/11/bdo-ifrs-frs102-differences.pdf>, accessed: 2019-02-25.

Coenenberg, Adolf G. et al. (2018): Jahresabschluss und Jahresabschlussanalyse.

Schäffer Poeschel, Stuttgart, 25. revised edition.

Deloitte (2018): Revenue from Contracts with Customers – A guide to IFRS 15.

<https://www.iasplus.com/en/publications/global/guides/a-guide-to-ifrs-15>. accessed: 2019-02-25.

FRS 102 (2018): The Financial Reporting Standards applicable in the UK and Republic of Ireland.

[https://www.frc.org.uk/getattachment/69f7d814-c806-4ccc-b451-aba50d6e8de2/FRS-102-FRS-applicable-in-the-UK-and-Republic-of-Ireland-\(March-2018\).pdf](https://www.frc.org.uk/getattachment/69f7d814-c806-4ccc-b451-aba50d6e8de2/FRS-102-FRS-applicable-in-the-UK-and-Republic-of-Ireland-(March-2018).pdf). accessed: 2019-02-25.

IFRS (2018): International Financial Reporting Standards. WILEY, Weinheim. 12. revised edition.

Pellens, Bernhard et al. (2017): Internationale Rechnungslegung, Schäffer Poeschel, Stuttgart. 10. revised edition.

PwC (2017): IFRS 9, Financial Instruments – Understanding the basics.

<https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-9/ifrs-9-understanding-the-basics.pdf>. accessed: 2019-02-25.



TAKING THE COMPLEXITY OUT OF FINANCE

Every day, we prove that managing financial data doesn't have to be rocket science. Since 1999, our user-friendly software solutions for Financial Performance Management have been in a class of their own: automated processes that make your job a lot easier. A single tool that presents financial data in a transparent, easy-to-understand way. Robust figures to back up every one of your business-related decisions. And when you have questions, our consultants and software experts are here for you – always.

For financial experts, by financial experts. Always fostering the most intelligent solutions. After all: consolidation, planning, reporting, and data management know no limits – so why should we? We're constantly challenging ourselves, questioning the tried-and-true. And this is why we do more than just create powerful applications: we create user experiences, helping you to fully grasp and navigate the intricacies of your company's finances and pave the way for a strong future.

Berlin is our home, but you'll find us wherever reliable financial data is needed. With a growing national and international presence and a strong network of partners, every day we're that much closer to you. And we've come a long way with our approach to rethinking finance: more than 2,700 companies in over 50 countries trust in LucaNet, including names such as FTI Touristik, edding, Leica, Roland Berger, and Vaude. Find out what they already know – and let us make finance easier for you, too.

CONTACT US

LucaNet (UK) Limited

Phone: +44 20 3880 1740

Email: info@lucanet.co.uk

Website: www.lucanet.co.uk

