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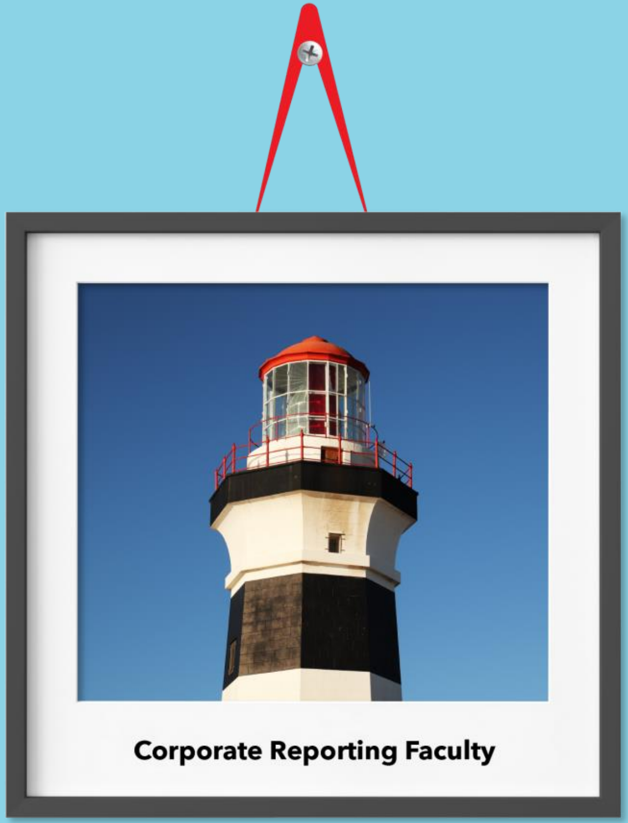

UK GAAP updates 2024

4 JULY 2024

THIS WEBINAR WILL
COMMENCE SHORTLY ……

Introduction

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Today's presenters

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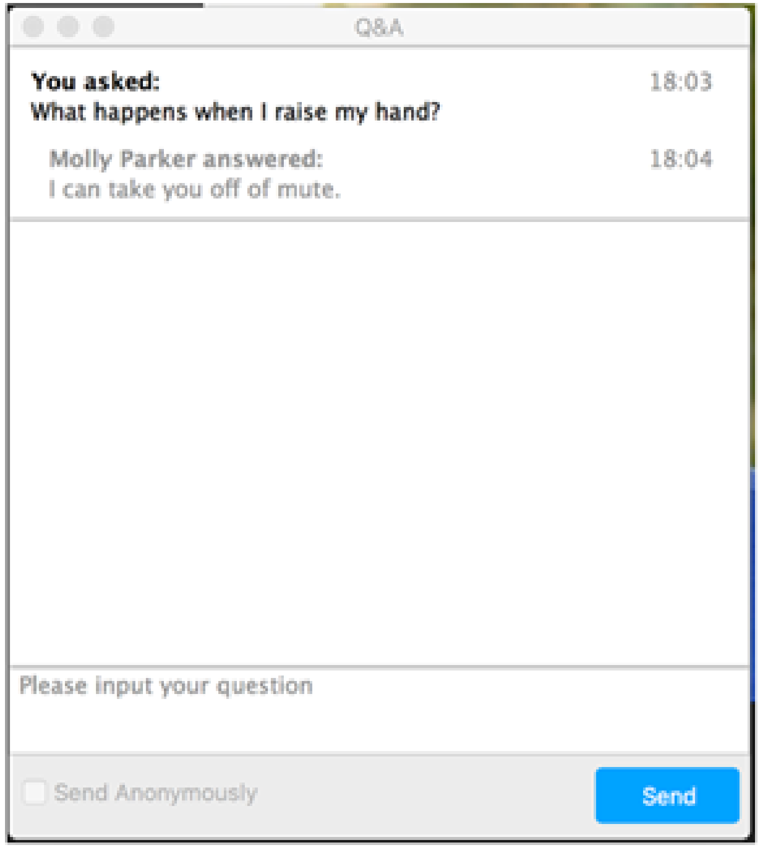
Ask a question and access resources



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Pillar Two Model Rules

- International tax reform addressing significant uncertainty around deferred tax
- Limited application – multinational groups with turnover >£750m
- The aim is to ensure that multinational enterprises pay a minimum effective rate of 15%
- First imposes a top up tax on parent companies with a backstop of a top up tax on lower level companies with low taxed income from certain jurisdictions
- Legislation enacted on 11 July 2023 but became effective for reporting periods ending on or after 31 December 2023
- Affects UK companies who expect to pay top up tax under the legislation
- Changes to FRS 102 (and FRS 101) as a result

The requirements

- Companies are prevented from recognising or disclosing any information about deferred tax assets or liabilities relating to Pillar Two income tax. Instead the following disclosures are required:
    - (If Pillar Two legislation is effective) Current tax expense / income relating to Pillar Two income tax
    - (if enacted but not yet effective) Qualitative and quantitative information about its exposure to Pillar Two income tax at the reporting date. Can be provided in the form of an indicative range but to the extent it is not known or reasonably estimable, there needs to be a statement to that effect with details of progress in assessing the exposure.
    - FRS 101 reporters can claim an exemption if the disclosures are in the consolidated accounts of the parent
    - FRS 102 reporters which are or expect to be in scope need to include a statement in the accounts to that effect.

The requirements (2)

- Restatement of comparative information is not required
- Given the legislation has been enacted but isn’t effective until 31/12/23 reporting periods:
  - Company with 31/12/23 year end – disclose based on requirements when effective
  - Company with 30/11/23 year end – disclose based on requirements where enacted but not yet effective
- As a rule of thumb – consider if there needs to be disclosure in consolidated financial statements where subsidiaries are paying top up tax in their own jurisdictions
- Generally relatively few FRS 102 reporters likely to be impacted by this – but there will be some
- The legislation is complex – so tax (as well as financial reporting) advice may well be needed

Coming soon – supplier finance arrangements

- This has been included as part of the recent revisions to FRS 102 and is not as yet effective.
- However, whilst the other revisions to FRS 102 are effective for accounting periods beginning on or after 1 January 2026, the supplier finance amendments are effective for accounting periods beginning on or after 1 January 2025
- As a result – would be very easy to miss them!
- Early application is permitted
- For FRS 102, amends section 7 (Statement of cash flows)
- Impact on FRS 101 being consulted on but not yet final
- Follows on from consideration by IFRIC of need for more disclosure / transparency in this area to meet the needs of users

What is a supplier finance arrangement?

- No specific definition given in FRS 102 as revised. Per para 7.20B:
- *‘Supplier finance arrangements are characterised by one or more finance providers offering to pay amounts an entity owes its suppliers and the entity agreeing to pay according to the terms and conditions of the arrangements at the same date as, or a date later than, suppliers are paid. These arrangements provide the entity with extended payment terms, or the entity’s suppliers with early payment terms, compared to the related invoice payment due date. Supplier finance arrangements are often referred to as supply chain finance, payables finance or reverse factoring arrangements. Arrangements that are solely credit enhancements for the entity (eg financial guarantee contracts) or instruments used to settle directly with a supplier the amounts owed (eg credit cards) are not supplier finance arrangements’*
- Given arrangements could be complex, providing additional disclosure does make sense

What has to be disclosed?

a) the key terms and conditions of the arrangements (eg extended payment terms, interest charges, and security or guarantees provided). However, an entity shall disclose separately the key terms and conditions of arrangements that have dissimilar key terms and conditions.

b) as at the end of the reporting period:

   i. the carrying amounts and associated line items presented in the entity's statement of financial position of the financial liabilities that are part of a supplier finance arrangement; and

   ii. the range of payment due dates (eg 30–40 days after the invoice date) for both the financial liabilities disclosed under sub-paragraph (i) and comparable trade payables that are not part of a supplier finance arrangement. Comparable trade payables are, for example, trade payables within the same line of business or jurisdiction as the financial liabilities disclosed under sub-paragraph (i). If ranges of payment due dates are wide, an entity shall disclose explanatory information about those ranges or disclose additional ranges (eg stratified ranges).

c) the type and effect of non-cash changes in the carrying amounts of the financial liabilities disclosed under sub-paragraph (b)(i). Examples of non-cash changes include the effect of business combinations, exchange differences or other transactions that do not require the use of cash or cash equivalents (see paragraph 7.18).

The impact

- Might be relatively limited but these types of arrangements are becoming more common
- What gets disclosed will need some thought and may not initially be obvious – so entities to which this applies should start thinking about it sooner rather than later.
- Some mitigating factors:
  - Qualifying entities are exempt from the disclosures if they are included in the relevant consolidated financial statements
  - When the requirements are applied for the first time (eg for a December 2025 year end) equivalent disclosures for the comparatives do not need to be given
- Auditors – expect this to be an area where the disclosures might not be that great!

Other upcoming changes to FRS 102

- Some big changes – and lots of little ones!
- Effective for accounting periods beginning on or after 1 January 2026 with early adoption permitted
- Will be covering this relatively briefly, as another ICAEW webinar on the changes is coming soon
- Focusing on the big changes – lease accounting and revenue recognition
- Expected credit loss model for impairment of financial assets not introduced

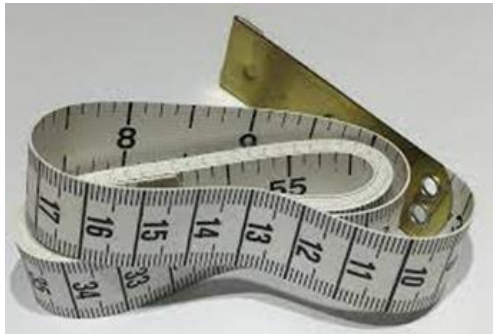
Lease accounting

- Brings FRS 102 in line with IFRS 16 (but less complex)
- Key point for lessees – all leases now go on balance sheet, with a few exceptions
- In other words, the distinction between operating leases and finance leases is eliminated (if you are a lessee)
- Quite a lot more disclosure required than currently
- Not much impact on lessors – for lessors the operating lease or finance lease model is retained

What are the exceptions?

- Exemption from the on balance sheet model for 2 types of leases
- Short term leases (those with a term of 12 months or less at the commencement date)
- Leases for which the underlying asset is of low value – which qualify for this treatment regardless of materiality to the lessee
- Gives examples of assets which would not be of low value (but not of ones that would be)
- Not low value – things like cars, plant, boats, planes, land and buildings
- No bright line like the $5k in IFRS 16 – so will require the application of judgement (and common sense!)
- Would expect most entities to take the exemption where relevant
- Entities adopting FRS 105 will also stick with the old model

Recognition and measurement – lease liability



- Lease liability – based on present value of minimum lease payments including fixed payments and variable payments based on an index or rate (plus certain other things)
- In substance pretty similar to existing finance lease accounting
- However, the interest rate used to calculate present value is:
  - The interest rate implicit in the lease; or
  - The incremental borrowing rate; or
  - The obtainable borrowing rate
- Would expect quite a few entities to use the obtainable borrowing rate (a simplification which doesn't exist in IFRS 16) as it will be a lot easier to determine than the other two options

Recognition and measurement – right of use asset

- Recognise a 'right of use asset' (can't have a credit without a debit!)
- Right of use asset – measured at amount of lease liability plus any upfront payments (e.g. deposits, direct costs, any costs to rectify at the end of the lease) minus any lease incentives
- Subsequently the ROU asset is measured either at cost less depreciation or at revalued amounts
- Cost less depreciation seen most commonly in practice with IFRS reporters

First time adoption

- Unlike IFRS, FRS 102 mandates a single approach to first time adoption
  - Lease liability for existing leases is the present value of the remaining lease payments at the date the revised requirements are first applied
  - Right of use asset is measured at the amount of the lease liability but adjusted for any previously recognised accruals or prepayments relating to operating leases
  - Comparatives are not restated
  - Any impact on profit or loss – adjust opening retained earnings
- No need to reassess whether a contract is or contains a lease
- For entities transitioning from IFRS, can elect to recognise the ROU asset and lease liability at the amounts recognised under IFRS 16
- Various other practical expedients

Revenue recognition

- Broadly aligns FRS 102 with the requirements of IFRS 15 – however in a less complicated fashion
- Brings in the 5 step model for revenue recognition
- Like IFRS 15, focuses on the contract with the customer
- For many entities, how revenue is recognised won’t actually change – but it will have an impact on some, which could be significant
- Change was expected to ensure comparability with IFRS
- Scope – all contracts with customers except leases, financial instruments, insurance contracts, certain barter transactions and non exchange transactions for public benefit entities
- Lots of additional disclosures

The five step process, in brief

- Identify the contract (hopefully customer already identified!)
- Identify the performance obligations in the contract (what has the entity agreed to do for the customer?)
- Determine the transaction price
- Allocate the transaction price between the different elements of the contract
- Recognise revenue for each element when the performance obligation has been satisfied (i.e. when the entity has done what they had agreed to do)
- Revenue may therefore be recognised at different points compared with previously – or not
- Various requirements as to when contracts should be either bundled or unbundled

First time adoption

- A choice on transition – either fully retrospective or retrospective but with the cumulative impact of transition presented as an adjustment to opening retained earnings at the date of initial application
- Various practical expedients
- Overall there are a number of simplifications from IFRS 15, many of which are optional, and some accounting policy choices e.g. in respect of costs of obtaining a contract
- Entities should consider the substance of their contractual arrangements with customers as soon as possible to determine whether the impact is likely to be significant and which options they wish to take

Poll question

Which of the key changes to FRS 102 do you think will have the most impact on your / your clients' financial statements?

a) Leases
b) Revenue recognition
c) Both
d) Neither

Topical issues

Topical issues and areas of uncertainty

Inflation and interest rates

- Continued source of estimation uncertainty
- May impact the carrying amount of assets and liabilities
- Sensitivity analyses may need revisiting

UK General Election in July

- Impact on timing of secondary legislation for ECCTA and company size reforms
- General uncertainty over the plans of a future government and their impact on financial reporting

Global uncertainty

- Continued impact of ongoing wars
- Supply chain implications
- Increase in shipping and transport costs plus additional shipping times

Climate change

- Increased pressure and scrutiny from investors and other stakeholders on how climate-related matters are reflected in the financial statements
- Impact of climate change on asset UELs, impairment considerations, provisions, grants, going concern

Economic Crime and Corporate Transparency Act 2023 (ECCTA)

Economic Crime and Corporate Transparency Act 2023 (ECCTA)

Received Royal Assent on 26 October 2023

Bill seeks to tackle economic crime and improve transparency over corporate entities

Companies House reforms effective from March 2024

New ‘failure to prevent fraud’ offence – guidance expected mid 2024

Other changes expected in 2024 and beyond

Reforms effective from 4 March 2024

‘Appropriate’ registered office addresses

Registered business email address

Confirm that company is being formed for a lawful purpose

Companies House will have greater powers to query and challenge information

Consequences if companies do not respond to a formal request from Companies House

Other upcoming reforms

- Removal of option to file filleted or abridged accounts
- Digital filing of fully tagged accounts
- Statement of eligibility for dormant company accounts and those taking audit exemption
- New limits to the number of times a company can shorten its ARD
- ID checks for company directors, PSCs, LLP members and general partners of limited partnerships
- Restriction on use of corporate directors
- Third party agent registration
- Dates TBC

New ‘failure to prevent’ offence

Organisations will be held criminally liable where a person associated with it (including employees, agents and subsidiaries) commits a fraud intending to benefit the organisation and it does not have reasonable procedures in place to prevent the fraud.

Offence will apply to all large organisations including:

- Companies
- Partnerships
- Not for profit organisations
- Incorporated public bodies

Organisations will be large if they meet 2 out of 3 of the following:

- More than 250 employees
- More than £36 million turnover
- More than £18 million in total assets

New ‘failure to prevent’ offence

Types of offences that could be committed include

- False accounting
- False representation
- Failure to disclose information
- False statements by company directors amongst others

What are reasonable procedures to prevent fraud?

- Government to publish guidance
- Offence will then come into force
- Transition period unknown
- Consider now if in scope
- Penalty is an unlimited fine

Non-financial reporting review feedback

Non-financial reporting review feedback

- Simplifications to the Directors' Report
- Company size threshold changes
- Changes to Directors' remuneration reporting within the Directors' Report
- Ongoing consultation on requirements for medium sized companies

Proposed simplifications to the Directors' Report

Areas proposed to be removed relate to:	
	Employment of disabled people
	Financial instruments
	Existence of branches
	Employee engagement
	Engagement with suppliers customers and others
	Important events, future developments and research and development

Company size limit changes

Increases to micro, small and medium thresholds

NET THRESHOLDS

	Micro		Small		Medium	
	Current	Proposed	Current	Proposed	Current	Proposed
Annual turnover	£632k	£1m	£10.2m	£15m	£36m	£54m
Balance sheet total	£316k	£500k	£5.1m	£7.5m	£18m	£27m
Average number of employees	10		50		250	

Company size limit changes: impact

Simpler reporting rules for more companies

eg use of reduced disclosures in FRS 102 1A or exemption from preparing a strategic report for small companies

More companies may be able to take advantage of audit exemption as a small company under the new thresholds

Important to remember that ineligibility rules will still apply, and an audit may still be required for other reasons

Other changes expected

Consultation with specific considerations for medium sized companies	Double the employee numbers to 500
	Potential exemption from preparing a strategic report

Poll question

What impact will the change in company size limits have on your business:

a) Nothing – we will remain in the same size category

b) Nothing – we cannot take small companies exemptions anyway eg, due to ineligibility or external stakeholder requirements

c) It will reduce our financial reporting burdens significantly

FRC thematic review of reporting by the UK’s largest private companies

Revenue mainly comprises direct sales to end-customers and the sale of goods to authorised third parties for resale. The Group recognises revenue when it transfers control over a product to a customer, excluding taxes, net of discounts and after elimination of intercompany sales.

Direct sales to end-customers are mainly made through retail stores for fashion goods, certain fragrance and beauty products, and certain watches and fine jewellery items. These sales are recognised at the time of purchase by the retail end-customers. Sales made in stores owned by third parties are treated as retail transactions if control of the inventories is retained by the Group.

Chanel Limited, Annual Report and Financial Statements for the year ended 31 December 2022, p63

Sets out the timing of recognition and how the transaction price is determined.

Clearly explains the nature of the revenue stream and the types of good sold.

Explains how sales made through third party stores are recognised.

FRC thematic review of reporting by the UK's largest private companies

Key themes

- Strategic report
- Primary statements and accounting policies
- Revenue
- Judgements and estimates
- Provisions and contingent liabilities
- Financial instruments
- Climate reporting

Judgements and estimates

Companies are required to provide information about:

- Significant judgements made by management in applying an entity's significant accounting policies, other than those relating to estimation uncertainty.
- Key sources of estimation uncertainty that have a significant risk of causing a material adjustment to assets and liabilities within the next financial year.

Judgements: good practice

Tailored to a companies' specific circumstances

Clear in terms of the precise judgements that have been made and the rationale for the conclusion

Example

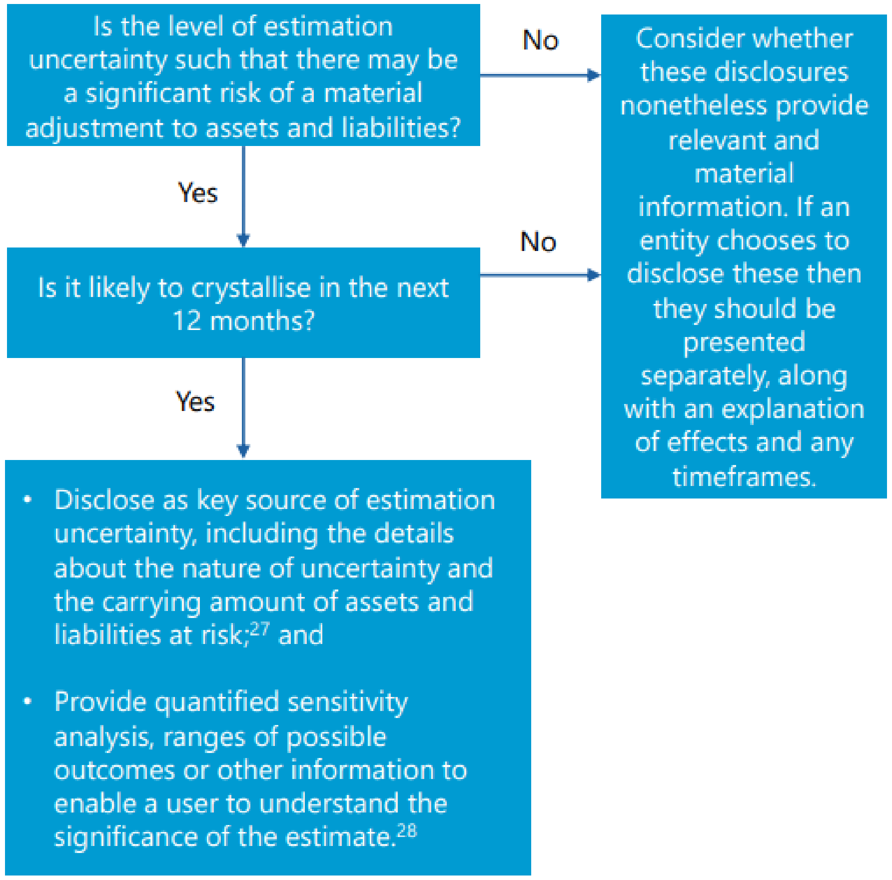
"Section 28 of FRS 102 permits an entity to recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or through refunds from the plan. ***In the opinion of the directors, the Group does not have an unconditional right to the surplus and therefore no surplus has been recognised.****"*

Estimates: good practice

Disclose only estimates that have a significant risk of material adjustment to assets and liabilities within the next 12 months

Disclose the carrying amounts of the assets and liabilities at risk

IFRS / FRS 101 reporters should provide additional forward-looking information



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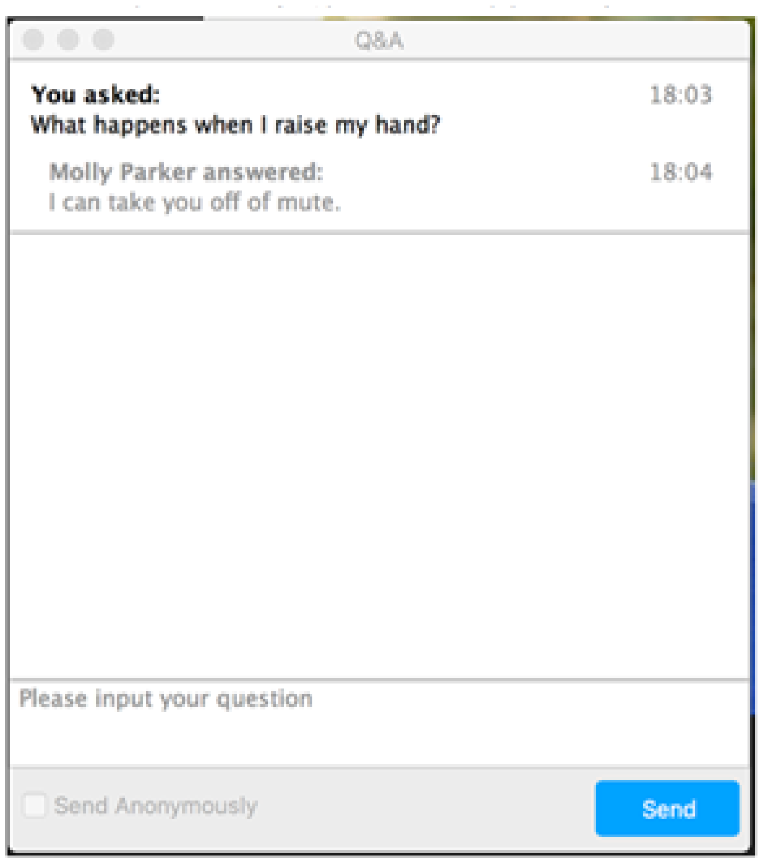

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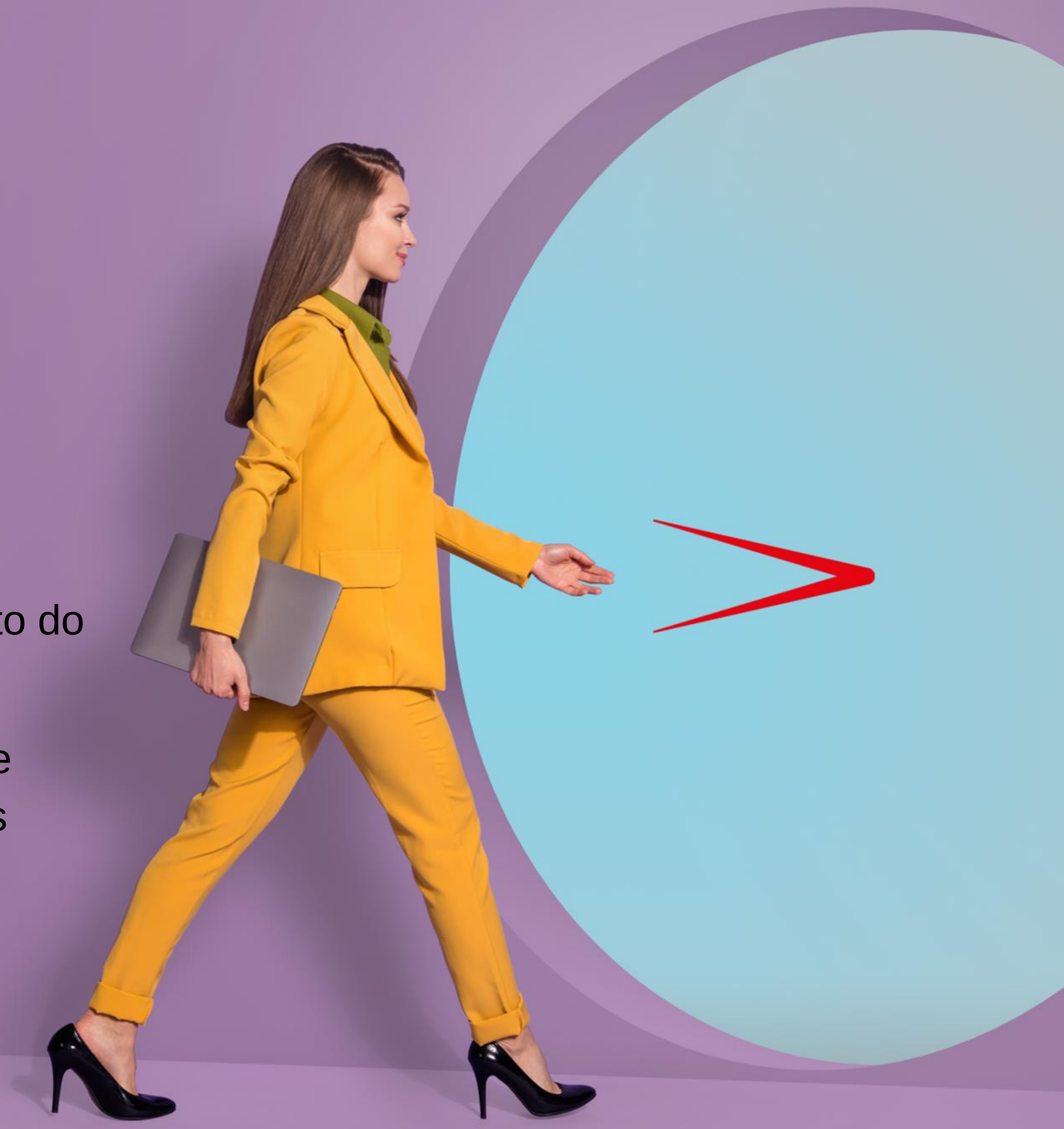

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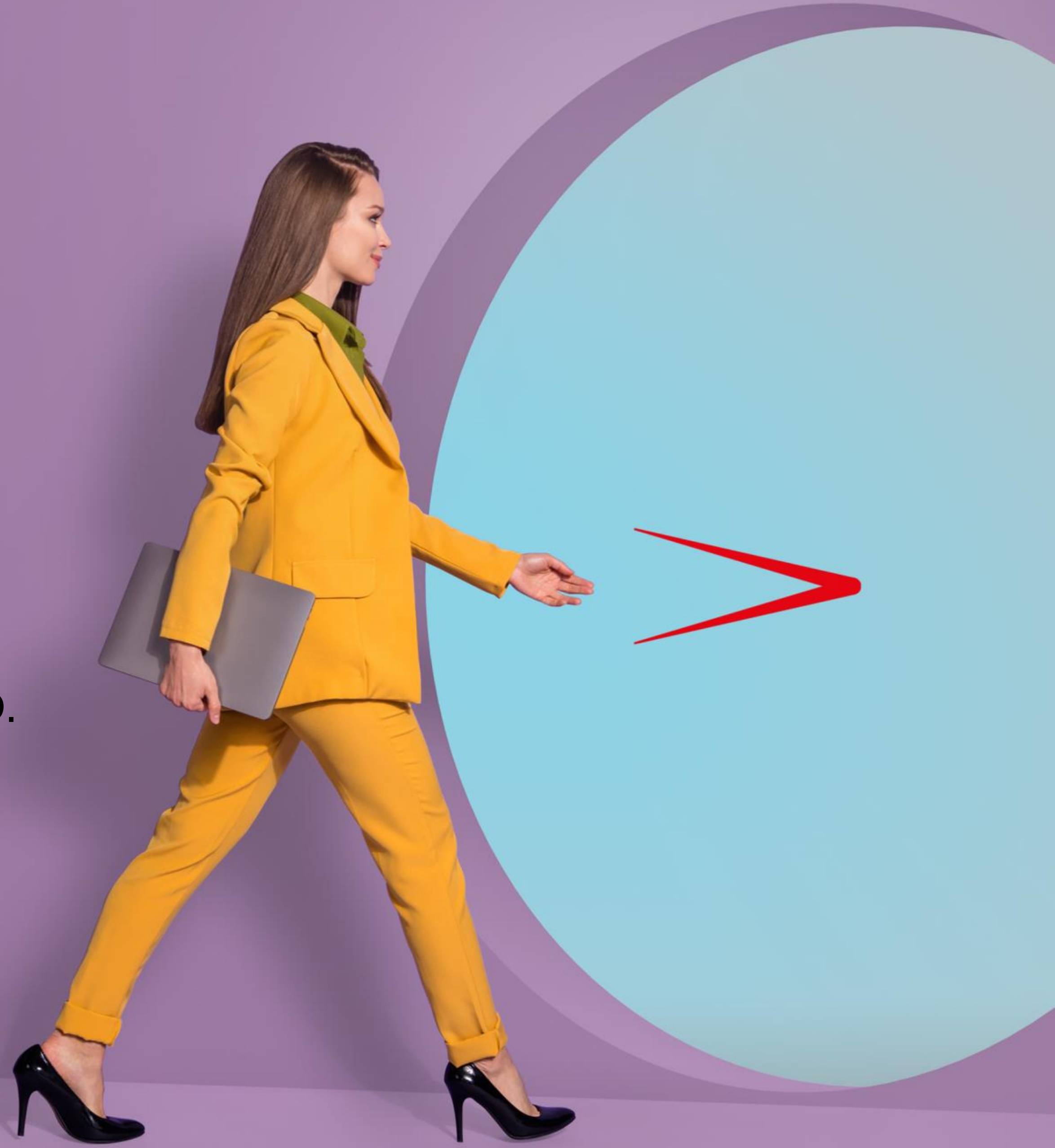
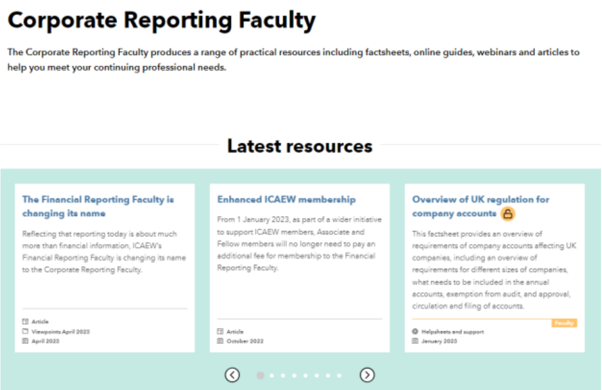


ICAEW resources

- UK GAAP – UK GAAP hub page
- Factsheets – corporate reporting factsheet
- Judgments and estimate guide
- By All Accounts faculty magazine:
  - Companies House reform article
  - Threshold changes article
  - Periodic review article
- Webinars and events
  - icaew.com/crfevents for upcoming events
  - icaew.com/crfwebinars for webinar recordings
- ICAEW CPD courses:
  - 2024: UK GAAP update

Corporate reporting at your fingertips



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Questions

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- Contact the Corporate Reporting Faculty.
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- Web: icaew.com/crfac

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