

# Changes in financial reporting

## Time to Think about Tax



Non-small entities in the UK and ROI are now in their first period of the new reporting standards brought in by Financial Reporting Standard 102 (FRS 102). This became effective for non-small entities in the UK and ROI for periods commencing on or after 1 January 2015. Small entities are being brought into line with FRS 102 (recognition and measurement elements) for periods commencing on or after 1 January 2016. Earlier adoption is permitted in both cases.

In this commentary we look at the reasons to start to review the impact of these changes on the current and deferred tax positions of companies.

### Tax impact of FRS 102

FRS 102 will have an effect on taxation in the following ways:

- the calculation of current tax;
- the calculation of deferred tax; and
- disclosure requirements, in particular the reconciliation to tax note.

HMRC has already prepared overview papers to assist companies applying the new standards which provide a summary of the key accounting changes and tax considerations that arise on transition to the new standards. It is expected that the **overview papers** will be updated as standards and legislation develop.

Broadly, in many areas tax follows the accounting treatment, unless, of course, there is specific tax legislation in place to the contrary. A different accounting treatment may, therefore, have an impact on tax payable.

### Current tax

#### GAAP for current tax purposes

The starting point for calculating profits chargeable to tax for a company is the company's profit or loss as calculated in accordance with generally accepted accounting principles (GAAP). This amount is then adjusted for any tax adjustments required or authorised by law in calculating profits for corporation tax purposes. Therefore, in transitioning to a new set of accounting standards, the starting point for corporation tax also changes.

FRS 102 alters how certain items are reflected and whether any movement in their

value will go through the profit and loss account. Understanding how these changes may impact on the tax computation for the first year of implementation is crucial.

Items such as intangibles, connected party loans and financial instruments may now have additional charges or credits which are reflected in the income statement which would not have appeared under the old UK GAAP. Assessing the value of these changes will mean a better understanding of any tax loss and dividend planning for the current year and going forward.

In some cases, for example companies which have received large lease incentives, it may be better to transition to the new UK GAAP earlier than is mandatory in order to accelerate a tax deduction.



### Deferred tax

#### Calculation of deferred tax

Deferred tax recognises the future tax effect of transactions which go through the current year profit and loss account. Any future tax liability or asset arising from events which have occurred by the period end should be recognised in the balance sheet of the company where it is prudent to do so.

FRS 102 requires the recognition of deferred tax on a more extensive list of items than was the case under old UK GAAP. Calculating the deferred tax position of a company will require additional details on the tax history of investment properties, shares held as investments and possibly a company's investments in subsidiaries, associates, joint ventures and branches.

## Deferred tax impact

Areas where FRS 102 requires that deferred tax is recognised, where there is currently no recognition under FRS 19 Deferred Tax are:

- On revaluations of non-monetary assets, such as fixed assets or investment properties, for which there is no binding agreement to sell and the gain or loss on sale has not been recognised.
- On unremitted earnings of subsidiaries, associates and joint ventures - where the income has not been accrued or there is no binding agreement in place to distribute the earnings.
- On rolled-over gains (arising on revaluations or disposals) prior to the assets into which the gains have been rolled over being sold.
- In relation to fair value adjustments in a business combination not recognised by the acquired entity in its own financial statements (e.g. on the write down of inventories).

## Disclosure requirements

Probably the main disclosure difference concerns the reconciliation to tax. Currently, FRS 19 requires a reconciliation of the current tax charge or credit reported in the profit and loss account to profit before tax multiplied by the applicable tax rate. However, FRS 102 requires a reconciliation of the total tax expense or income for the period (as included in profit or loss). Small entities continue to be exempt from taxation disclosures under FRS 102.



## Disclosure impact

There are a number of other disclosure differences between FRS 102 and current GAAP:

- FRS 102 requires an analysis of the major components of the aggregate tax charge/credit recognised in the financial statements to be given whereas FRS 16 and FRS 19 require this analysis to be given separately for tax recognised in profit or loss and other comprehensive income.
- FRS 102 does not require disclosure of movements in deferred tax balances in the period or of unrecognised deferred tax amounts which are required by FRS 19.
- FRS 102 requires disclosure of the net reversal of deferred tax expected to occur in the period following the reporting period. This is not required under FRS 19.
- FRS 102 requires disclosure of the tax expense relating to discontinued operations but FRS 16 does not.
- There are no expected disclosure requirements in respect of current tax for small entities applying both FRS 102 and revised company law, as disclosures for such entities will instead usually be restricted to those required by the law. However, the financial statements of small entities may include the disclosures above if they are deemed necessary to achieve true objective of giving a true and fair view.

## Assessing the impact

The potential tax consequences of transition to the new UK GAAP will need to be assessed early so that you can appropriately communicate the effect of any changes and help your clients prepare for the impact of implementing new UK GAAP or, in some circumstances, identify where early adoption may be an attractive option.

Recognition of deferred tax in a wider range of situations could significantly impact the balance sheet position of affected businesses.

## How can Mercia help?

We have been keeping you up-to-date with the development of these new accounting requirements with our:

- **courses**
- **webinars**
- **client letters**
- **newswire**
- **blogs**

You can rest assured that we will continue to keep you up-to-date and take closer looks at the areas of change in the months ahead. You will find details of everything that we do on our website at [www.mercia-group.co.uk](http://www.mercia-group.co.uk) and a subscription to our free monthly newswire is a great way of keeping yourself up to date with these. Subscribers to our **Audit Manual** already have access to a fully updated version for new UK GAAP, including **new UK GAAP disclosure checklists** written in accordance with FRS 101 and FRS 102.

If you are specifically looking for training on the new UK GAAP, our training programmes are available on our website and you can search for courses in your area using our **course search facility**.

We have also developed an online transition library which is a suite of 31 easy reference FRS 102 e-learning modules. Further details of this can be found at:

[www.mercia-group.co.uk/newukgaap](http://www.mercia-group.co.uk/newukgaap)