

White paper

Key differences between UK GAAP and IFRS

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1

Introduction

This white paper gives an overview of key differences between accounting policies under FRS 102 and full IFRS.

Companies in the UK with securities admitted to trading on a regulated market are required to prepare their consolidated financial statements in accordance with IFRS, even after the Brexit. All other groups and companies in the UK have the choice to follow either IFRS or UK GAAP. UK GAAP includes six standards, which have been available in an updated version since September 2024:

- 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*
- FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*

We focus on FRS 102, which is the core of the standards. The requirements in FRS 102 are based on the IFRS for SMEs (International Financial Reporting Standard for Small and Medium-sized Entities.) FRS 102 is a single financial reporting standard that applies to the financial statements of entities that are not applying adopted IFRS, FRS 101, or FRS 105. This standard takes into consideration that users of private entity financial statements have different information needs to users of listed entities, and reduces the costs and difficulty in preparing financial statements for private entities.

This white paper gives an overview of key differences between accounting policies under FRS 102 and full IFRS, but should not be interpreted as an exhaustive list. In each section, the respective accounting policy is first described under FRS 102, and then compared to the corresponding rules under IFRS. Some topics no longer differ due to regulatory changes, while others have been added. We have decided to name all of these topics.

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Consolidated financial statements

2.1 Parent-subsidiary relationship

The existence of parent-subsidiary relationships is the basis for the preparation of consolidated financial statements in every jurisdiction. According to the **control concept**, a parent-subsidiary relationship exists when the parent company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities (FAS 102.9.4). This power is usually provided by a **majority of voting rights**.

The principle of completeness applies, i.e. all subsidiaries must be consolidated, regardless of their activity, location, or size. However, there are prohibitions on the consolidation of subsidiaries,

- a) there are significant and continuing restrictions on the exercise of rights relating to assets and management; or
- b) the subsidiary has already been acquired with the intention of resale.

In the case of (a), it is necessary to assess whether at least significant influence remains, so that the subsidiary is accounted for as an associate using the equity method.

Subsidiaries that are still immaterial, both individually and in the aggregate, need not be included. There is only one option to include immaterial subsidiaries.

IFRS 10 provides significantly more leeway in explaining the parent-subsidiary relationship to resolve complex cases. However, as both IFRS 10 and FAS 102 are based on the same control concept, IFRS 10 can be used as an interpretation aid for FAS 102 in difficult cases. In addition, IFRS 5 requires a subsidiary acquired with the intention of resale to be recognized as held for sale, a recognition and measurement category that does not exist in FAS 102.

2.2 Business combinations

A business combination is the bringing together of separate entities (share deal) or businesses (asset deal) into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. The acquisition date is the date on which the acquirer obtains control of the acquiree. Business combinations are generally recognized using the purchase method. The application of the purchase method requires the following steps:

- (a) identifying an acquirer;
- (b) determining the acquisition date;
- (c) measuring the cost of the business combination ("consideration");
- (d) allocating, at the acquisition date, the cost of the business combination to the assets acquired, and liabilities and provisions for contingent liabilities assumed, and recognizing and measuring any non-controlling interest in the acquiree; and
- (e) recognizing and measuring any positive or negative goodwill.

Once these points have been clarified, the initial consolidation can be carried out. In particular, the following points should be emphasised where there are differences to IFRS 3:

Re (c): The consideration for the business combination includes the fair values of the assets given, liabilities incurred or assumed, and equity instruments issued at the acquisition date, plus all costs directly attributable to the business combination (incidental acquisition costs such as notary fees, land transfer tax, commissions etc.)

Contingent considerations that depend on future events (earn-out arrangements) must be recognized as liabilities and included in the cost of the business combination as a present value. Subsequent changes in estimates of the contingent considerations will result in adjustments to both the liability and the cost of the business combination.

According to IFRS 3, on the other hand, incidental acquisition costs are not part of the consideration; they must be recognized as an expense. In addition, any contingent consideration must be estimated at the acquisition date and included in the consideration. This value remains unchanged, even if estimates of future events change. However, the liability is recognized at fair value through profit or loss in future periods.

Re (d): The purchase method is only applied in the form of the so-called revaluation method (ie “partial” or “purchased goodwill method”), according to which the non-controlling interests are only recognized in the amount of their share of the revalued net assets of the acquired business. Under IFRS 3, the full goodwill method is also permitted as an individually exercisable option. In this case, the acquired business is recognized at its total enterprise value in the consolidated financial statements, which also leads to an extrapolation of goodwill for the non-controlling interests. If there are no non-controlling interests, the revaluation method and the full goodwill method lead to the same result.

For information on recognizing the difference between (c) and (d) as (positive or negative) goodwill, see the following two sections.

2.3 Goodwill

Goodwill (arising from the above) offsetting must be recognized as an asset. In future periods, it must be amortized on a systematic basis over its estimated useful life, and impairment losses should also be recognized. If, in exceptional cases, an entity is unable to make a reliable estimate of the useful life of goodwill, the life shall not exceed 10 years.

In contrast, according to IFRS 3 there only applies the impairment-only approach: Goodwill may not be amortized on a systematic basis over its useful life, but is subject to an annual impairment test, which may lead to impairment losses.

2.4 Negative goodwill

If the above offsetting results in a negative goodwill, the correct valuation of the net assets acquired and the cost of the business combination must be reassessed. If this still results in a negative difference, this must be recognized as negative goodwill on the assets side of the statement of financial position and offset against any existing positive goodwill. In subsequent periods, it must be released to income in line with the realization of the non-monetary assets acquired. Any excess exceeding the non-monetary assets acquired shall be recognized in profit or loss in the periods expected to be benefited.

IFRS 3 also provides for a reassessment of the measurement of the net assets acquired if a negative difference has been identified. If this remains the case, there is an excess on a bargain purchase that must be recognized immediately in profit or loss.

2.5 Equity method

The equity method is applied to associates and joint ventures in the consolidated financial statements. Initial measurement is at cost. Gains and losses resulting from ‘upstream’ and ‘downstream’ transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognized in the entity’s financial statements only to the extent of unrelated investors’ interests in the associate or joint venture.

IAS 28 also provides for initial measurement at cost and pro rata elimination of profits and losses with the same scope of application. However, in September 2024, the IASB published the Exposure Draft 2024/7 on the revised version of IAS 28. According to this, acquisition costs will be defined as the fair value of the consideration, meaning that incidental acquisition costs must be recognized as an expense. In addition, the elimination of gains and losses from ‘upstream’ and ‘downstream’ transactions using the equity method is to be completely abolished. It can be assumed that these regulations will be implemented in this way. However, the date of initial application has not yet been set.

3

Statement of financial position

3.1 Intangible assets other than goodwill

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.

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).

Initial and subsequent measurement

In both FRS 102 and IAS 38 an entity shall measure an intangible asset initially at cost. After initial recognition an entity shall measure intangible assets using the cost model or the revaluation model. Under the revaluation model, an intangible asset shall be carried at a revalued amount, being its fair value at the date of revaluation less any subsequent

accumulated amortization and subsequent accumulated impairment losses, provided that the fair value can be determined by reference to an active market. This also applies to IAS 38.

The requirement for the existence of an active market limits the practical significance of the revaluation method considerably. The following explanations therefore focus on the cost model.

Useful life

In accordance with FRS 102, paragraph 18.19, all intangible assets are presumed to have finite useful lives. If, exceptionally, an entity is unable to make a reliable estimate of the useful life, the useful life should not exceed 10 years.

IAS 38.88 requires an entity 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. If the useful life is indefinite, i.e. there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows, the intangible asset is not amortized. In accordance with IAS 36, *impairment of assets*, an enterprise should test intangible assets with indefinite useful lives for impairment each period.

3.2 Leases

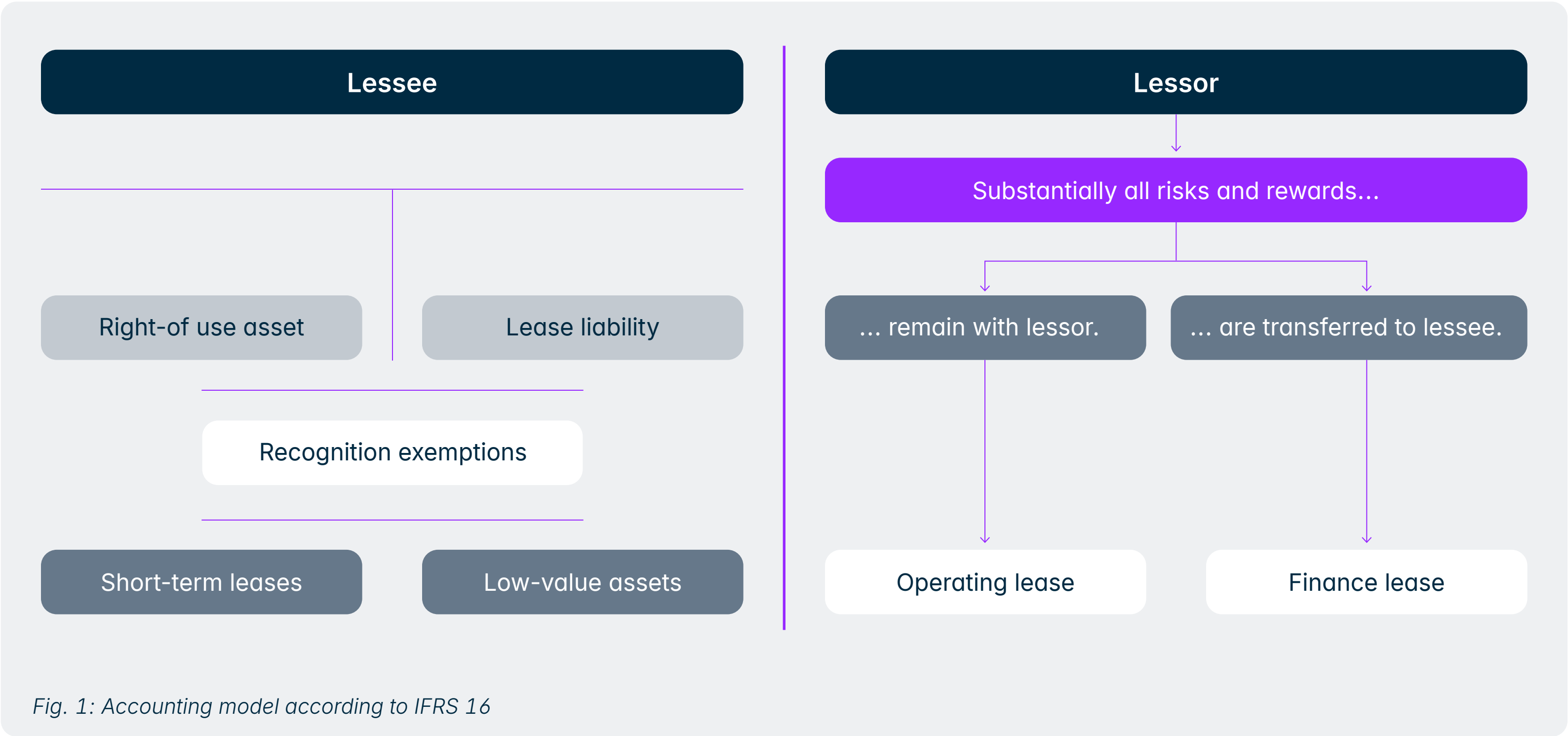
In the January 2022 version of FRS 102, leases still had to be categorized by the lessee as finance or operating leases. In the September 2024 version, FRS 102 now follows the line of IFRS 16: with the exception of short-term leases (up to one year) and low-value leased assets, all leases are recognized in the balance sheet. This means that there are no longer any fundamental differences between FRS 102 and IFRS 16.

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 from the lease in the statement of financial position. The asset is subject to depreciation, whereas the liability is accounted for using the effective interest method.

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.

The following diagram shows lease accounting for the lessee and the lessor in accordance with both FRS 102 and IFRS 16.



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.

3.3 Investment property

Under FRS 102, investment property shall be initially measured at cost. Cost also includes 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*, investment property is also measured initially at cost, including directly attributable expenditure. For subsequent measurement, though, IAS 40 provides an **accounting choice**. 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.

3.4 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 one 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* together with 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 IAS 39 (as amended following the publication of IFRS 9) together with the 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. However, users of IFRS 9 have the option of applying the remaining hedge accounting provisions of IAS 39 (see c above.) If an entity decides for the provisions of IAS 39 (see b above), 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 loans receivable or payable), and investments in non-derivatives (e.g. ordinary shares) are typically classified as basic financial instruments.

These instruments are initially recognized at the transaction price, adjusted for transaction costs if they are not subsequently measured at fair value through profit or loss. Debt instruments are subsequently measured at amortized cost using the effective interest method. To avoid an accounting mismatch, there is an individually exercisable option to measure certain debt instruments at fair value through profit or loss (FRS 102.11.14bi.) Listed equity instruments (shares) are measured at fair value through profit or loss, others at amortized cost (FRS 102.11.14d.)

When measuring financial assets at amortised cost, an assessment must be made at the end of each reporting

IAS 39 distinguishes between four categories of financial assets and two categories of financial liabilities, with each having their own recognition and measurement rules.

period as to whether there is objective evidence that a financial asset is impaired (FRS 102.11.21.) FRS 102.11.22 lists indicators for objective evidence of impairment of a financial asset.

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 and are designed as hedging instruments. Such financial instruments are generally measured at fair value through profit or loss (FVPL), except for some 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 FVPL; 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)

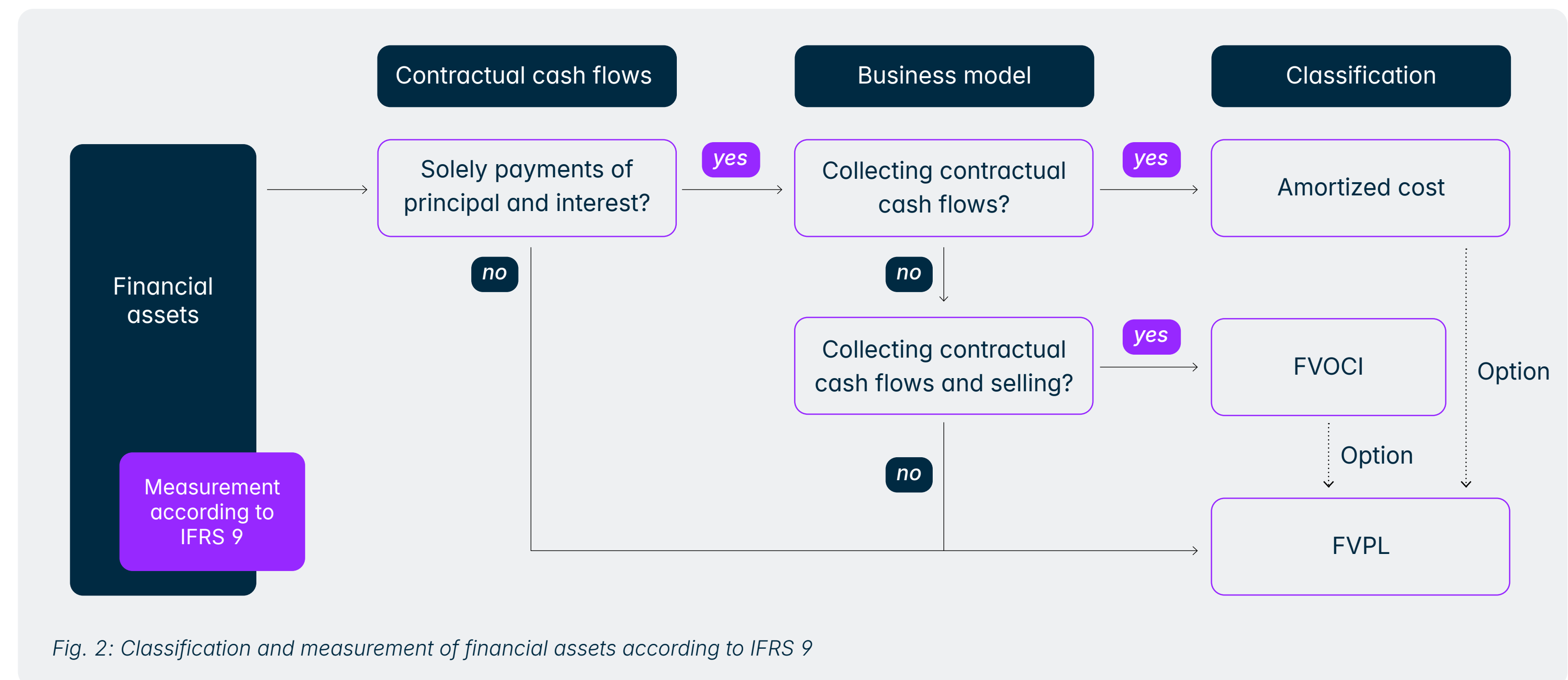
Financial liabilities are classified as either:

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

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

Financial liabilities are generally measured at AC, except for the objects stated in IFRS 9.4.2.1. In addition, to eliminate or significantly reduce a measurement or recognition inconsistency ("accounting mismatch") an entity may, at initial recognition, a financial liability irrevocably designate at FVPL (IFRS 9.4.1.5.)

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 usually 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.

According to IAS 12 *Income taxes*, deferred taxes shall be recognized using the temporary concept which is based on the statement of financial position.

3.5 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.

There are no timing differences in the initial measurement of the net assets acquired in a business combination (excluding goodwill.) For this reason, deferred taxes are to be recognised on the carrying amount differences between the tax balance sheet of the acquired company and the net assets recognised in the consolidated financial statements (FRS 102.29.11.)

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. Therefore, there is no need for special regulations for business combinations. 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.

4

Statement of comprehensive income

4.1 Revenue recognition

Section 23 of FRS 102 (January 2022) defined various categories of revenue. Revenue recognition was based on a risks and rewards approach. The new version of FRS 102 (September 2024) now follows the control approach of IFRS 15 Revenue from Contracts with Customers: Revenue is generally recognized when an entity transfers control of an asset (i.e. a good or service) to a customer (IFRS 15.31.) As a result, there are no material differences between FRS 102 and IFRS 15 in the recognition of revenue from contracts with customers. Both follow a five-step revenue recognition model that applies to all contracts with customers (see Fig. 3.)

At first, an entity must assess whether a contract is in the scope of the standard. Therefore, a contract has to meet some criteria (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.

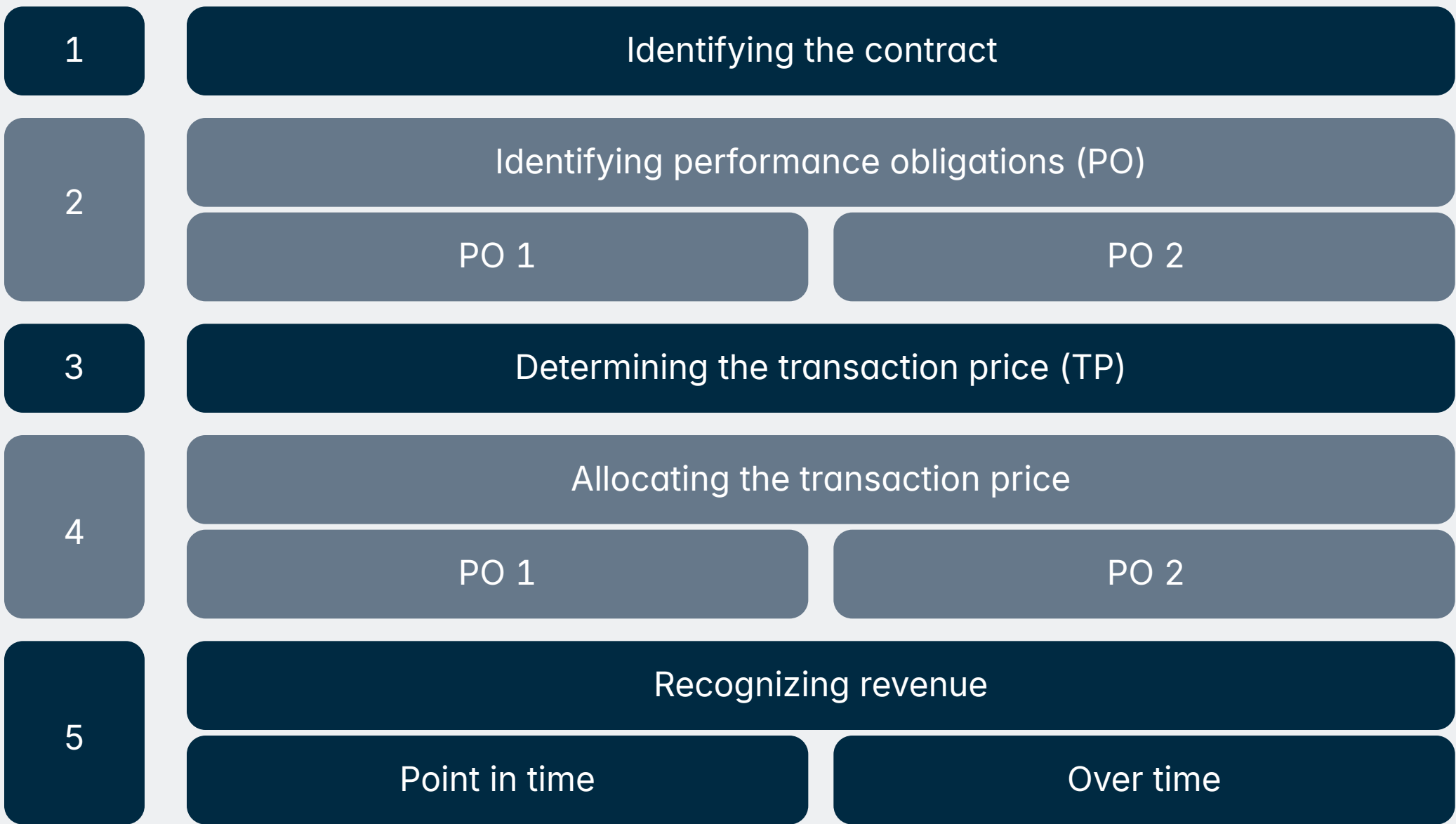


Fig. 3: The five-step model according to FRS 102 and IFRS 15

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.

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. For instance, revenue from services is generally recognized over time.

4.2 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 oder 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 expense in the period in which they are incurred, e.g. using the effective interest method.

5

Summary

Topics	UK GAAP	IFRS
Acquisition of a subsidiary with the intention of resale	Prohibition of consolidation	Recognition as held for sale
Business combinations	- Measure the consideration at fair value, including any costs directly attributable to the business combination - Partial goodwill method	- Measure the consideration at fair value, excluding any other costs - Partial or full goodwill method
Goodwill	Is considered to have a finite life and is subject to amortization	Is considered to have an indefinite life and is subject to an annual impairment test
Negative goodwill	After reassessment disclose below goodwill on the face of the statement of financial position	After reassessment immediately recognition in profit or loss
Equity method	Proportionate elimination of gains or losses from 'upstream' and 'downstream' transactions	Just the same, but in future the elimination of gains or losses from 'upstream' and 'downstream' transactions is to be completely abolished
Intangible assets	- May capitalize development costs - Finite useful life and thus subject to amortization	- Must capitalize development costs - Determination if useful life is finite or indefinite
Leases	All leases generally lead to the recognition of a right-of-use asset and a lease liability	Just the same
Investment property	Measured at fair value, with changes in fair value recognized in profit or loss	Accounting choice between the fair value model and the cost model
Financial instruments	Choice between the provisions of FRS 102, IAS 39 or IFRS 9	Only IFRS 9 is applicable
Deferred taxes	Timing concept	Temporary concept
Revenue recognition	- Control approach - Five-step model to be applied	Just the same
Borrowing costs	May be capitalized for a qualifying asset	Have to be capitalized for a qualifying asset

Author profile

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