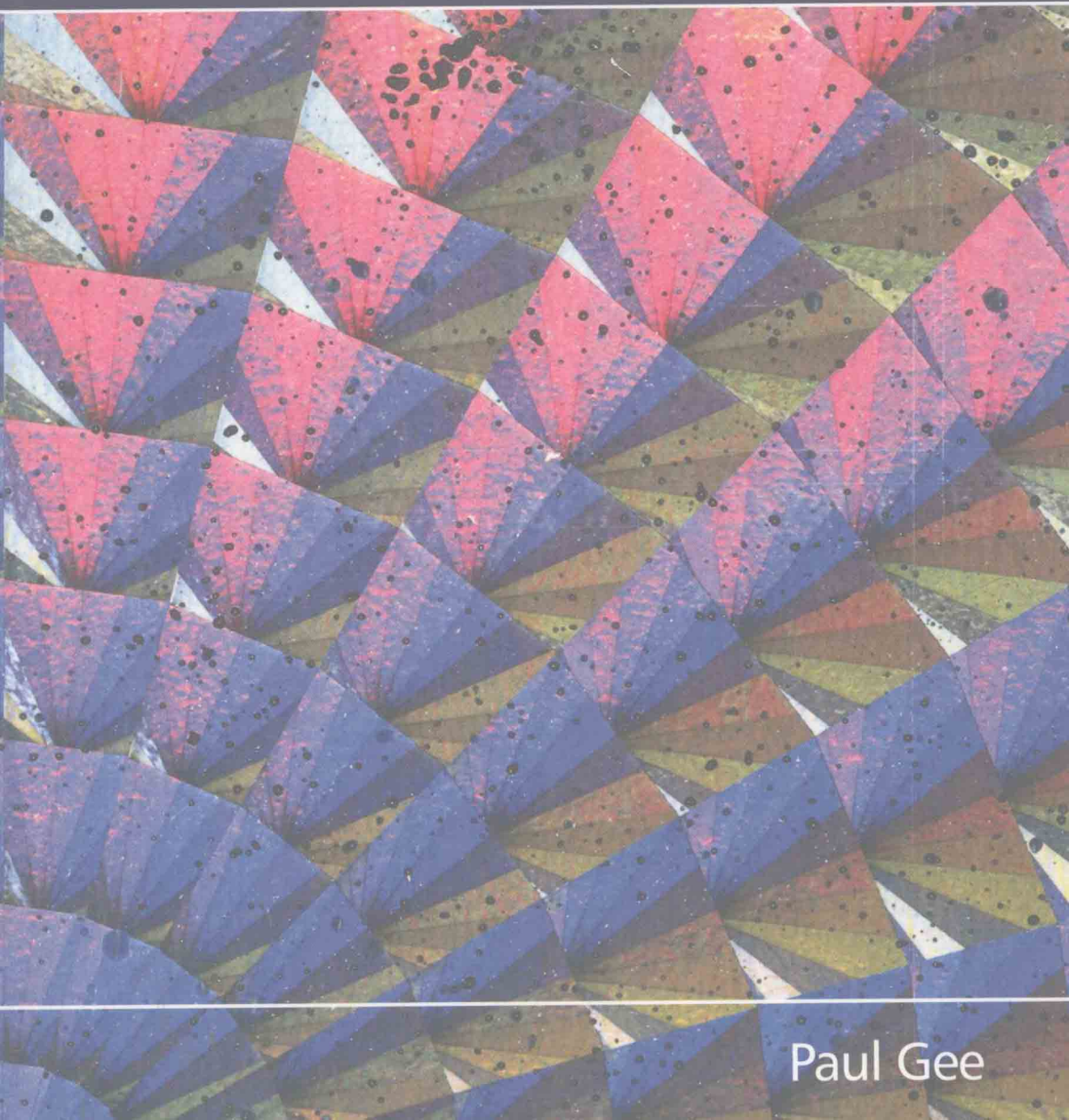


UK GAAP

for Business and Practice



Paul Gee

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Paul Gee

*Technical Director, Solomon Hare,
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Contents

1 Executive Summary 2005	1
1.1 UK GAAP or IFRS?	1
1.2 Recent Developments	2
1.3 Recent Financial Reporting Standards	3
1.4 Recent Financial Reporting Exposure Drafts	5
1.5 Earlier Financial Reporting Standards	5
1.6 The Financial Reporting Standard for Smaller Entities (FRSSE)	5
1.7 Urgent Issues Task Force Developments	6
1.8 Company Law Changes	6
1.9 Listed Company Reporting	8
1.10 Financial Reporting Review Panel (FRRP)	8
1.11 Statements of Recommended Practice (SORPs)	8
1.12 International Financial Reporting Standards	8
2 The UK Regulatory Framework	10
2.1 Companies Act 1985 Requirements	10
2.2 Financial Reporting Council (FRC)	16
2.3 Accounting Standards Board (ASB)	17
2.4 Urgent Issues Task Force (UITF)	18
2.5 Statements of Recommended Practice (SORPs)	18
2.6 Statement of Principles	19
2.7 Companies (Audit, Investigations and Community Enterprise) Act 2004	20
2.8 The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005	21
2.9 Companies Act 1985 (Investment Companies and Accounting and Audit Amendments)	23
2.10 Legal Opinion on Role of Accounting Standards and True and Fair	24
2.11 Directors' Report	25
2.12 Revision of Defective Accounts	28
2.13 Financial Reporting Review Panel	29
2.14 International Financial Reporting Standards	31
3 Accounting Policies and Estimation Techniques	33
3.1 Objectives of FRS 18	33
3.2 Concepts	33
3.3 Definitions	34
3.4 Examples	35
3.5 Concepts and Objectives – Further Comments	36
3.6 Changes in Accounting Policies	37



3.7 Estimation Techniques	37
3.8 Disclosures	38
3.9 Illustration	39
3.10 International Financial Reporting Standards	43
4 Profit and Loss Account, Statement of Total Recognized Gains and Losses (STRGL) and Balance Sheet	44
4.1 Introduction	44
4.2 FRS 3 – The Profit and Loss Account	48
4.3 Exceptional Items	51
4.4 Extraordinary Items	54
4.5 Discontinued Operations and Provisions	55
4.6 Operations in the Process of Being Discontinued	56
4.7 Profit or Loss on Disposal of Fixed Assets	56
4.8 FRS 3 – The Statement of Total Recognized Gains and Losses (STRGL)	57
4.9 FRS 3 – Other Statements	57
4.10 Prior Period Adjustments	60
4.11 Comparative Figures	66
4.12 International Financial Reporting Standards	66
5 Cash Flow Statements	68
5.1 Background and Scope	68
5.2 Format and Content – Single Companies	69
5.3 Worked Example – A Single Company Using the Indirect Method	75
5.4 Problem Areas – Single Companies	79
5.5 Group Accounts Considerations	80
5.6 Worked Example – A Group	81
5.7 Illustrations from Published Accounts	86
5.8 Using Cash Flow Statements	88
5.9 International Financial Reporting Standards	89
6 Reporting the Substance of Transactions	90
6.1 Background	90
6.2 The Substance of Transactions	91
6.3 Features of More Complex Transactions	91
6.4 Applying the Principles of FRS 5	92
6.5 Recognition of Assets and Liabilities	93
6.6 De-recognition	94
6.7 Relationship with Other Standards	96
6.8 Disclosure Requirements	97
6.9 Linked Presentation for Certain Non-recourse Finance Arrangements	98



6.10 Offset	99
6.11 Consignment Stocks	100
6.12 Debt Factoring and Invoice Discounting	102
6.13 Sale and Repurchase Agreements	105
6.14 Further Complications	108
6.15 International Financial Reporting Standards	109
 7 Converging UK GAAP with IFRS	 110
7.1 Terminology	110
7.2 Recap	110
7.3 Options for Members of a Group	110
7.4 Application to Different Categories of Company	111
7.5 Comparison of UK GAAP and IFRS	111
7.6 True and Fair Requirement	117
7.7 Converging UK GAAP with IFRS – Recent Developments	118
7.8 Urgent Issues Task Force Abstracts	119
7.9 Extant Standards	119
 8 Revenue Recognition	 121
8.1 Introduction	121
8.2 The Statement of Principles – Recognition in Financial Statements	122
8.3 FRS 5, Application Note G	123
8.4 Contracts for Services and UITF Abstract 40	131
8.5 Other Aspects of UK GAAP	137
8.6 Review Panel Press Notices	138
8.7 Illustrations from Published Accounts	139
8.8 International Financial Reporting Standards	141
 9 Employee Benefits	 143
9.1 Directors' Remuneration – Unlisted Companies (Other than those Claiming Small Company Exemptions under CA 1985 s246)	143
9.2 Directors' Remuneration – Other Disclosures	145
9.3 Directors' Remuneration – Small Companies Claiming Exemptions Under CA 1985, Part VII	147
9.4 Retirement Benefit – Introduction	148
9.5 Retirement Benefit – Companies Act 1985 Requirements	148
9.6 Funding of Pension Arrangements	149
9.7 Accounting for Retirement Benefits – FRS 17: Introduction	150
9.8 FRS 17 – Transitional Provisions	150
9.9 FRS 17 – Full Implementation	152
9.10 International Financial Reporting Standards	156

10	Share-based Payment	158
10.1	Overview	158
10.2	Employee Share Schemes – UITF Abstract 17	159
10.3	National Insurance Contributions on Share Option Gains – UITF Abstract 25	162
10.4	Accounting for ESOP Trusts – UITF Abstract 38	165
10.5	Share-based Payment, FRS 20	168
10.6	International Financial Reporting Standards	178
11	Taxation Including Deferred Tax	179
11.1	Accounting for Current Tax	179
11.2	Deferred Tax – Introduction	181
11.3	Accounting for Deferred Tax – FRS 19	184
11.4	Accounting for Deferred Tax – FRS 19: Deferred Tax Assets	186
11.5	Accounting for Deferred Tax – FRS 19: Disclosure Requirements	188
11.6	Accounting for Government Grants	194
11.7	SSAP 5 (Accounting for Value Added Tax)	196
11.8	International Financial Reporting Standards	196
12	Tangible Fixed Assets, Including Impairment	198
12.1	Introduction	198
12.2	Tangible Fixed Assets – Overview of FRS 15	199
12.3	Determining Cost	200
12.4	Capitalization of Interest	202
12.5	Revaluation	203
12.6	Depreciation	208
12.7	Website Development Costs	213
12.8	Impairment	215
12.9	Disposal of Fixed Assets	220
12.10	UITF 5 – Transfers from Current Assets to Fixed Assets	221
12.11	Investment Properties (SSAP 19)	221
12.12	Government Grants for Capital Expenditure	223
12.13	International Financial Reporting Standards	224
13	Intangible Fixed Assets, Including Goodwill	226
13.1	Introduction	226
13.2	Accounting for Goodwill – FRS 10	227
13.3	Intangible Assets (Other than Goodwill)	231
13.4	UITF 27 – Revision to Estimates of the Useful Economic Life of Goodwill and Intangible Assets	232
13.5	FRS 10 Disclosure Requirements – Overview	232
13.6	Accounting for Research and Development Expenditure	233
13.7	International Financial Reporting Standards	236



14 Hire Purchase and Leasing	238
14.1 Introduction – Financing of Fixed Assets	238
14.2 Hire Purchase – Accounting for the Hirer	239
14.3 Lessee Accounting – Background	240
14.4 Lessee Accounting – Classification	242
14.5 Lessee Accounting – Finance Leases and Hire Purchase Contracts	244
14.6 Lessee Accounting – Operating Leases	247
14.7 Lessee Accounting Disclosures Finance Leases	248
14.8 Lessee – Accounting Disclosures – Operating Leases	250
14.9 Lease Classification and FRS 5	251
14.10 Lessor Accounting – Background	252
14.11 Lessor Accounting – Operating Leases	252
14.12 Lessor Accounting – Finance Leases	253
14.13 Manufacturer/Dealer Lessor	255
14.14 Lessor Accounting Disclosure Requirements	256
14.15 Sale and Leaseback	258
14.16 UITF 28 – Operating Lease Incentives	258
14.17 International Financial Reporting Standards	260
15 Current Assets	262
15.1 Stocks and Long-term Contracts – Overview	262
15.2 Short-term Stocks and Work-in-Progress	263
15.3 Long-term Contracts	269
15.4 Debtors	283
15.5 Current Asset Investments	286
15.6 Cash	286
15.7 International Financial Reporting Standards	286
16 Loans, Provisions, Contingencies and Commitments	288
16.1 Introduction	288
16.2 Creditors and Loans	288
16.3 Provisions	289
16.4 Contingencies	298
16.5 Commitments	300
16.6 International Financial Reporting Standards	301
17 Financial Instruments	302
17.1 Overview	302
17.2 FRS 4, Capital Instruments – Shareholders' Funds	304
17.3 FRS 4, Capital Instruments – Debt	309
17.4 FRS 25 – Financial Instruments: Disclosure and Presentation	310
17.5 International Financial Reporting Standards	313

18 Shareholders' Funds and Dividends	315
18.1 Introduction	315
18.2 Share Capital Disclosures – Companies Act 1985	315
18.3 Reserves – Categories	317
18.4 Permitted Reserves Movements	319
18.5 FRS 25 – Financial Instruments: Disclosure and Presentation	319
18.6 Purchase and Redemption of Shares – CA 1985 Rules	321
18.7 Distributable Profits	325
18.8 International Financial Reporting Standards	327
19 Related Party Transactions	328
19.1 Introduction to FRS 8	328
19.2 Identifying Related Parties	329
19.3 Related Party Transactions – Definitions and Examples	331
19.4 Disclosure Requirements	331
19.5 Companies Act 1985 – Directors' Interests in Contracts	334
19.6 International Financial Reporting Standards	335
20 Events after the Balance Sheet Date	337
20.1 SSAP 17 – Post Balance Sheet Events	337
20.2 FRS 21 – Events after the Balance Sheet Date	340
20.3 International Financial Reporting Standards	343
21 Segmental Reporting	344
21.1 The Need for Segmental Analysis	344
21.2 Companies Act 1985 Requirements	344
21.3 SSAP 25 – Segmental Reporting	345
21.4 Terminology	345
21.5 Disclosure Requirements	345
21.6 Relaxations for Smaller Entities	346
21.7 Summary of SSAP 25 Requirements	346
21.8 International Financial Reporting Standards	349
22 Accounting for Smaller Companies	351
22.1 Reporting Requirements – an Overview	351
22.2 Statutory Definitions	352
22.3 Shorter Form of Accounts for Shareholders	354
22.4 The Financial Reporting Standard for Smaller Entities (FRSSE) – Overview	356
22.5 Using the FRSSE – Accounting and Disclosure Issues	357

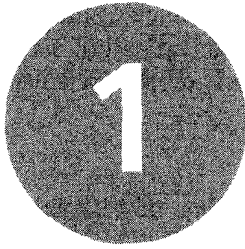


22.6 Using the FRSSE (Effective January 2005) – Accounting and Disclosure Issues	366
22.7 Abbreviated Accounts	368
22.8 Small and Medium-sized Groups	369
22.9 Concessions Offered by Particular Accounting Standards	369
22.10 Legal Considerations	370
22.11 Parent Companies	371
22.12 Audit Exemption	371
22.13 International Financial Reporting Standards	372
23 Listed Company Reporting	373
23.1 Introduction	373
23.2 Fully Listed or AIM – Who Makes the Rules?	373
23.3 Members of a Listed Group – UK GAAP or IFRS?	374
23.4 Directors' Remuneration – Additional Considerations	375
23.5 Operating and Financial Review (OFR)	375
23.6 Financial Reporting Review Panel (FRRP)	376
23.7 International Financial Reporting Standards Specific to Listed Companies	377
24 Limited Liability Partnerships	379
24.1 Introduction	379
24.2 Legal and Administrative Matters	380
24.3 Accounts and Audit	381
24.4 Statement of Recommended Practice (SORP)	383
24.5 Summary – Comparisons with Unlimited Partnerships and Limited Companies	387
24.6 Exposure Draft of Proposed Revised SORP	388
24.7 International Financial Reporting Standards	388
25 Accounting for Subsidiary Undertakings	390
25.1 Requirement to Prepare Consolidated Accounts	390
25.2 Definitions – Parent Undertaking and Subsidiary Undertaking	390
25.3 “Dominant Influence” and “Managed on a Unified Basis”	391
25.4 Accounting Policies	392
25.5 Intra-group Items	392
25.6 Accounting Dates	393
25.7 Exclusion from Consolidation	394
25.8 Minority Interests	396
25.9 Individual Profit and Loss Account of Parent Company	397
25.10 Exemptions from the Preparation of Group Accounts	397
25.11 Significant Restrictions on Distributions	403
25.12 International Financial Reporting Standards	404

26 Acquisition Accounting, Fair Values and Business Disposals	406
26.1 Accounting for Business Combinations	406
26.2 Features of Acquisition Accounting	407
26.3 Fair Values and Acquisition Accounting	408
26.4 The Merger Reserve (CA 1985, s 131)	410
26.5 Acquisition Accounting Illustration	411
26.6 Acquisition Accounting Disclosures	413
26.7 Changes in Stake	417
26.8 Accounting for Disposals of Shares in Subsidiary Undertakings	420
26.9 Realization of the Merger Reserve	426
26.10 Merger Accounting	428
26.11 International Financial Reporting Standards	432
27 Associates and Joint Ventures	434
27.1 Introduction	434
27.2 Regulatory Environment – Overview	435
27.3 Classification of Fixed Asset Investments	436
27.4 Cost Method and Equity Method Compared – an Introduction	436
27.5 Investments in Subsidiaries	439
27.6 Associates	439
27.7 Joint Ventures	442
27.8 Acquisitions and Disposals	444
27.9 Commencement or Cessation of an Associate or Joint Venture Relationship	445
27.10 Loss-making Associates and Joint Ventures	445
27.11 Joint Arrangements not Entities (JANES)	446
27.12 Investor not Preparing Consolidated Accounts	447
27.13 Associates and Joint Ventures – Further Disclosures	448
27.14 International Financial Reporting Standards	450
28 Accounting for Overseas Operations	451
28.1 Introduction	451
28.2 Accounts of Individual Companies	451
28.3 Consolidation of Foreign Subsidiaries – an Introduction	455
28.4 Closing Rate/Net Investment Method	456
28.5 Temporal Method	463
28.6 Equity Investments Financed by Foreign Borrowings	464
28.7 Foreign Branches	467
28.8 Foreign Associated Companies	468
28.9 Disclosure in Financial Statements	468
28.10 International Financial Reporting Standards/FRS 23	469



29 Converging UK GAAP with IFRS – the Road Ahead	471
29.1 Convergence Experience to Date	471
29.2 Progress During 2005	472
29.3 ASB December 2005 Convergence Paper	472
29.4 And Finally	473
Appendix 1 Implementation Dates for Unlisted Companies	474
A1.1 Accounting Standards and UITF Abstracts: Mandatory	474
A1.2 Accounting Standards and UITF Abstracts: Optional	474
A1.3 Company Law Changes	475
Appendix 2 UK GAAP Status Report as at 31 January 2006	476
A2.1 Statements of Standard Accounting Practice	476
A2.2 Financial Reporting Standards	477
A2.3 Financial Reporting Exposure Drafts	479
A2.4 Abstracts Issued by UITF	479
A2.5 Statements of Recommended Practice (SORPs)	481
Appendix 3 Extant IASs and IFRSs: Status Report as at 31 January 2006	483
A3.1 International Accounting Standards (IASs)	483
A3.2 International Financial Reporting Standards	485
Appendix 4 Useful Website Addresses	486
Index	487



Executive Summary 2005

This chapter covers:

- * UK GAAP or IFRS?
- * Regulatory developments
- * Recently-issued Financial Reporting Standards, UITF Abstracts and Exposure Drafts
- * The Financial Reporting Standard for Smaller Entities (effective January 2005)
- * Company law changes affecting disclosure
- * Financial Reporting Review Panel activity

1.1 UK GAAP or IFRS?

Prior to 2005, all UK companies were required by the Companies Act 1985 (CA 85) to adopt UK GAAP (Generally Accepted Accounting Practice).

Following changes in EU Regulations, *fully listed groups* are required to adopt International Financial Reporting Standards (IFRS) in their *consolidated* accounts for accounts periods commencing on or after 1 January 2005. The European Regulation is mandatory for the *consolidated* accounts only. The Companies Act 1985 offers a number of options for the individual accounts of the members of a group (see 7.3).

Companies listed on the Alternative Investment Market (AIM) are outside the scope of the EU's so-called IAS Regulation, but are required by the London Stock Exchange to adopt IFRS for accounts periods commencing on or after 1 January 2007 (AIM companies may adopt earlier if they so choose).

All other categories of UK companies are permitted (*but not required*) to adopt IFRS for accounts periods commencing on or after 1 January 2005, but CA 85 prohibits earlier adoption.

The terms "International Financial Reporting Standards" (IFRS) and "International Accounting Standards" (IAS) are effectively interchangeable. The Companies Act 1985 and the relevant tax legislation refer to "IAS". However, the more widely used (and more modern) term IFRS is used in this book.

This book deals mainly with the application of UK GAAP, although Chapter 7 refer to IFRS and convergence issues, and IFRS is referred to at the end of each chapter. In addition, Chapter 23 gives a brief overview of listed company issues.

1.2 Recent Developments

The Accounting Standards Board (ASB) has issued a number of Financial Reporting Standards (FRSs) and Financial Reporting Exposure Drafts (FREDs) as part of its programme for converging UK GAAP with IFRS. The FRSs are:

- FRS 21, Events after the balance sheet date;
- FRS 22, Earnings per share;
- FRS 23, The effects of foreign exchange rates;
- FRS 24, Financial reporting in hyperinflationary economies;
- FRS 25, Financial instruments: Disclosure and presentation;
- FRS 26, Financial instruments: Measurement;
- FRS 27, Life Assurance.
- FRS 28, Corresponding amounts;
- FRS 29, Financial instruments: Disclosures.

No further reference is made to FRS 27 in view of its specialized application. FREDs are referred to in 1.4 below.

Chapter 29 deals with ASB's future plans for converging UK GAAP with IFRS. Other key pronouncements from ASB include:

- An updated version of the Financial Reporting Standard for Smaller Entities (FRSSE) – referred to as the “effective January 2005” version – see below and also Chapter 22;
- Reporting Standard 1 (RS 1) dealing with the Operating and Financial Review, superseded in January 2006 by best practice statement with non-mandatory status but with similar content and wording.

The Urgent Issues Task Force (UITF) has issued a number of Abstracts, in draft or final form. Of these, the most important is Abstract 40 dealing with Revenue recognition and service contracts. In essence, this requires that revenue on service contracts should be accrued as contract activity takes place (the “stage of completion” method).

Company law changes include:

- Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 [Statutory Instrument 2947];
- Companies (Audit, Investigations and Community Enterprise) Act 2004;
- Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005 [as amended 2006];
- Companies Act 1985 (Investment Companies and Accounting and Audit Amendments) Regulations 2005 [Statutory Instrument 2280].

These are available on the Office of Public Sector Information website (www.opsi.gov.uk).



1.3 Recent Financial Reporting Standards

(a) Events after the Balance Sheet Date (FRS 21)

This standard is identical to IAS 10 and is one of many bringing UK GAAP closer to IFRS. The standard mirrors changes to the Companies Act 1985 and supersedes SSAP 17 for accounts periods beginning on or after 1 January 2005 (for legal reasons, earlier adoption is not permitted).

With one important exception, the standard is broadly similar in effect to SSAP 17. The exception is the treatment of proposed *equity* dividends. Dividends declared after the balance sheet date should not be reported as liabilities. Declared dividends will be reported in a memorandum note in the accounts of the current year, and entered in the accounting records in the following year when the payment is actually made (see Chapter 20).

(b) Earnings per Share (FRS 22)

FRS 22, based on International Accounting Standard 33 (IAS 33), is to be applied to entities whose ordinary shares or potential ordinary shares (for example, convertible loan stock) are publicly traded, and by entities that are in the process of issuing ordinary shares or potential ordinary shares in public markets.

This standard will not be relevant for fully listed companies which head up a group as the consolidated accounts should follow IFRS. However some companies whose shares are publicly traded, for example AIM companies, may not be required to adopt IFRS immediately in which case FRS 22 will be relevant.

FRS 22 supersedes FRS 14, Earnings per share and is mandatory for accounts periods beginning on or after 1 January 2005.

(c) The Effects of Foreign Exchange Rates (FRS 23)

This standard is based on IAS 21 and over a period of time will supersede SSAP 20. FRS 23 cannot be adopted earlier than FRS 26, but once FRS 26 has been adopted, then FRS 23 must be adopted at the same time.

FRS 23 is broadly similar in effect to SSAP 20 although there are some important differences of detail (see Chapter 28).

(d) Financial Reporting in Hyperinflationary Economies (FRS 24)

In a hyperinflationary economy, reporting of operating results and financial position in the local currency, without any restatement, does not provide useful information in view of the rate at which money is losing purchasing power.

The aim of FRS 24 is to provide a mechanism for restating historical amounts that will enhance comparability of results and financial position.

(e) *Financial Instruments: Disclosure and Presentation (FRS 25)*

The objective of FRS 25 is to

“enhance financial statement users’ understanding of the significance of financial instruments to an entity’s financial position, performance and cash flows”.

The *presentation* requirements of the standard deal with a number of issues including:

- Classification of a company’s financial instruments into liabilities and equity – for example, whether preference shares should be presented in the balance sheet as debt or equity;
- Classification of related interest, dividends, losses and gains – whether they should be presented in the profit and loss account as finance items, or whether they should be taken direct to equity and presented as a movement on profit and loss reserves;
- The circumstances in which financial assets and financial liabilities should be offset.

The extensive *disclosure* requirements of FRS 25 deal with risk management policies and hedging activities.

The *presentation* aspects of the standard are mandatory for all types of companies for accounts periods beginning on or after 1 January 2005. The *disclosure* parts of the standard come into effect as soon as an entity adopts or is required to adopt FRS 26.

(f) *Financial Instruments: Measurement (FRS 26)*

The objective of FRS 26 is to establish principles for recognizing and measuring financial assets and liabilities. The standard sets out detailed rules as to the basis on which particular categories of assets and liabilities should be measured. The standard is based on the measurement parts of IAS 39—this standard is sometimes referred to as a mixed measurement model (effectively a mix of historical cost measurement rules and fair value rules).

FRS 26 applies to all types of financial instruments including cash, accounts receivable, accounts payable, loans, debt, equity securities held as assets, and derivatives. There are a number of exemptions from aspects of the standard, particularly in specialized areas.

The standard is mandatory for listed entities (for example, where the *individual* accounts of the listed parent are prepared in accordance with UK GAAP as opposed to IFRS or where the listed parent does not prepare consolidated accounts) as well as for any other entity that prepares its accounts in accordance with the fair value rules in the Companies Act 1985. Other entities may adopt it voluntarily in which case they must also adopt FRS 23, FRS 24 and the disclosure parts of FRS 25. The transitional provisions are complex—they are referred to in Chapter 17.