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Audit, April 2013

Financial Reporting Brief.

The new accounting framework for Irish companies has been completed with the publication of FRS 102 following on from the publication of FRS 100 and FRS 101 in late 2012 – for many, the most significant development in accounting of our generation.

FRS 102, *'The Financial Reporting Standard Applicable in the UK and Republic of Ireland'* is effective from 2015 onwards, with early adoption available.

The FRC has also published a consultation draft of revised guidance for directors on going concern and liquidity risks, and related standards for auditors. The Financial Reporting Lab has published two project reports (1) presentation of market risk disclosures, and (2) directors pay and performance.

The International Accounting Standard Board (IASB) continues to build IFRS 9 Financial Instruments with publication of an exposure draft on impairment of financial assets, setting out its proposals for a new accounting model based on expected losses. The impairment of non-financial assets has also received attention with an exposure draft on the disclosure of recoverable amounts, and a separate research report indicating significant inconsistencies in European listed companies' impairment accounting and reporting practices.

The International Integrated Reporting Council (IIRC) has announced memorandums of understanding with both the IASB and the Global Reporting Initiative (GRI), and has indicated that it expects to issue a draft of the Integrated Reporting Framework in April with the final version expected in December 2013. The IASB has published the first results of a survey on the perceived "disclosure problems", highlighting the need for greater focus on information relevant to users.

The International Valuation Standards Council (IVSC) has issued two documents (1) an exposure draft of proposed amendments to certain core valuation standards, and (2) a discussion paper on valuation of liabilities.

The European Securities and Markets Authority (ESMA) has published a review of 2011 financial statements related to impairment testing of goodwill, highlighting a number of areas of concern.

The Central Bank has published its enforcement priorities and its planned series of themed reviews and inspections for 2013.

This Brief comments on accounting and regulatory developments during the first quarter of 2013.

Financial Reporting Council and Related Bodies - Developments

The New Irish GAAP

The FRC has published FRS 102 The Financial Reporting Standard Applicable in the UK and Ireland. For the majority of Irish companies the new standard will replace current Irish GAAP. The new standard is effective for accounting periods beginning on or after 1 January 2015, with early adoption available. For insurers, the FRC is developing a separate standard, FRS 103.

Click here for a summary of the main features in our Financial Reporting Brief Special Edition>


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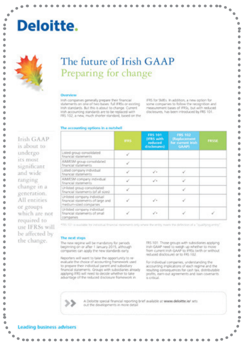
Financial Reporting Brief Special Edition
The New Irish GAAP

Financial reporting brief
special edition March 2013

Click here for the practical implications of moving to a new accounting framework>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The future of Irish GAAP
Preparing for change

The future of Irish GAAP
March 2013

Going Concern and Liquidity

The FRC has issued a consultation paper of proposed new guidance for directors, and proposals to amend related standards for auditors, to implement the recommendations of the Sharman Panel of Enquiry into Going Concern and Liquidity Risks.

The Sharman Report, published in June 2012, raised questions about the quality of information provided on companies' financial health and their ability to withstand economic and financial stresses in the short, medium and longer term.

The FRC has recommended in its proposed Guidance that to improve the robustness and reporting of the going concern assessment, the boards of companies should:

- Consider the threats to the company's business model and capital adequacy, over a period longer than twelve months, looking through the economic cycle and the company's business cycle;
- Develop a high level of confidence that solvency and liquidity risks can be managed effectively for at least twelve months from approval of the financial statements;
- Always disclose significant risks to solvency and liquidity and how they are managed, as part of the discussion of principle risks in the business review; and
- Confirm that it has undertaken a robust going concern assessment.

Auditors should consider the board's report on the robustness of the assessment of going concern and liquidity and the resulting disclosures in the annual report, and confirm in their auditors report that they have nothing to add or to draw attention to, or report otherwise.

The FRC consultation paper is open for comment until 28th April 2013.

Market Risk Disclosures.

The FRC has issued a Financial Reporting Lab project report on Presentation of Market Risk Disclosures. Matters considered in the report include:

- Presenting risk developments and actions taken in the reporting period, separately from policy related information which would be shown in an appendix; and
- The content of market risk disclosures, how they are used and best presented in practice.

The focus is on reducing the volume and complexity of reporting, while still conveying information proportionate to the underlying exposures, thereby eliminating unnecessary clutter,

Directors Pay and Performance

The Financial Reporting Lab, at the request of the UK Department of Business Innovation and Skills (BIS), explored the views of investors and companies on two new regulatory proposals:

- Scenario charts demonstrating how directors pay varies with performance; and
- A chart of company CEO pay based on the single figure for remuneration with company performance, measured using Total Shareholders Return (TSR).

There is significant agreement on core matters, including that the disclosures should be supplemented with a simple table showing historic levels of CEOs pay together with information on the level of performance related elements of pay.

International Accounting and Related Developments

Impairment of Financial Assets

The IASB has published an exposure draft setting out its proposals for a new accounting model for impairment of financial assets. The proposals are for the recognition of expected credit losses on financial assets and on commitments to extend credit, based upon current estimates of expected shortfalls in contractual cash flows as at the reporting date. This is to replace the incurred loss model currently used under IAS 39.

The proposals bring within its scope a wide range of financial assets and instruments. The impairment amount is based on whether they have significantly deteriorated since their initial recognition, with three stages:

- **Stage 1** – credit quality has not significantly deteriorated since initial recognition
- **Stage 2** – credit quality has significantly deteriorated since initial recognition
- **Stage 3** – objective evidence of impairment as at the reporting date

For stage 1, expected losses are recognised over the next twelve months, while for stages 2 and 3, expected losses are recognised over the remaining lives of the financial instruments. The approach is simplified for trade and lease receivables, with losses recognised over the remaining lives without differentiation between Stage 1 and Stages 2/3.

The exposure draft also proposes that interest recognition should be on a gross basis for stages 1 and 2, and on a net basis for stage 3.

An effective date has not been proposed pending completion of redeliberations. Comments are due by 5 July 2013.

The proposals differ from the current proposals of the FASB, with the FASB requiring a single measurement model recognising a charge equal to the present value of lifetime expected losses at initial recognition.

Hedge Accounting

The IASB has proposed urgent changes to both IAS 39 and the forthcoming hedge accounting chapter of IFRS 9. The proposals are to permit the continuation of hedge accounting where hedge instruments are novated to a central counterparty in accordance with laws or regulations introduced by jurisdictions to implement G20 agreed reforms around over the counter (OTC) derivatives.

Impairment of Non-Financial Assets

The IASB has published an exposure draft 'Recoverable Amount Disclosures for Non-Financial Assets' (proposed amendments to IAS 36). It proposes to narrow the application of the requirement to disclose the recoverable amount of an asset, and to clarify that disclosure of the recoverable amount of cash-generating units (CGU's) is required only where an impairment loss is recognised by a CGU. The proposals also amend and clarify the disclosures required when an asset is impaired and its recoverable amount is determined on the basis of the asset's fair value less costs of disposal.
A recent research report shows inconsistencies in IFRS compliance reflected in European listed companies' impairment reporting practices. Amongst the findings is that those disclosure requirements with more entity-specific focus are less rigorously followed than those that require less effort or can be dealt with by 'boilerplate' disclosures. The proposed amendments, when adopted, would apply retrospectively.

Integrated Reporting

The IASB and the IIRC have announced a memorandum of understanding (MoU) to create the basis for cooperation, coordination and alignment in areas of mutual interest in their efforts to promote the global harmonisation and clarity of corporate reporting frameworks.

The IIRC has also entered into an MoU with the GRI with the same purpose.

The IIRC expects to issue a consultation draft of its financial reporting framework in April with the final version expected in December 2013.

Disclosure Survey

A survey carried out by the IASB to gain a clearer picture on the perceived "disclosure problem" highlights the following:

- Over 80% consider improvements could be made, with many indicating a need for improvement across all parts of the annual report; and
- Most preparers commented that too little attention was being paid to exclude immaterial information, with users requesting more focus on relevant information.

The IASB is carrying out further research into the findings.

Income Tax

The European Financial Reporting Advisory Group, with the FRC, has posted a feedback statement on the IASB Discussion Paper 'Improving the Financial Reporting of Income Tax'. There is much support of the proposals on (a) effective tax reconciliation, (b) improved disclosure on deferred tax assets and tax losses, and (c) recognition and measurement of uncertain tax positions. Less supported proposals are (a) reconciliation of the tax paid with the current tax expense, (b) discounting of deferred tax assets and liabilities, (c) disclosure of uncertain tax positions, and (d) disclosures that involve forward looking and 'entity sensitive' information.

Convergence of Standards.

The G20 Finance Ministers and Central Bank Governors have again expressed concern at their most recent summit meeting about the delay in convergence of accounting standards, and have called on the IASB and the FASB to finalise by the end of 2013 their work on key outstanding projects for achieving a single set of high quality standards. Projects which need particular focus have been identified as those on insurance contracts and impairment of financial assets.

Valuation Standards

The IVSC has issued

- An exposure draft of numerous proposed amendments to International Valuation Standards – including proposals from the IVSC's projects on valuation reviews and the valuer's reliance on information, and introduces the 'unit of valuation' concept; and
- A discussion paper on valuation of liabilities – the first stage in a project to determine appropriate valuation standards for liabilities (other than those arising from financial instruments).

The comment period for both the exposure draft and discussion paper is 30 April 2013.

Goodwill Impairment

ESMA has published a review of 2011 IFRS financial statements with regard to impairment testing of goodwill and other intangible assets. ESMA comments that relatively few European entities have recognised any significant impairment and questions whether the level of impairment appropriately reflects the difficult operating environment. ESMA also expresses concern that in many cases disclosures are 'boiler plate' and not entity- specific.

The reviews highlighted five areas of concern where disclosures need to be improved (a) key assumptions underlying cash flow forecasts, (b) sensitivity analysis, (c) determination of recoverable amount, (d) determination of growth rates, and (e) disclosure of an average discount rate on each material cash generating unit.

Late Payments Regulations

With effect from 16 March 2013, new regulations have been introduced for late payments in commercial transactions imposing stricter guidelines on payment terms and interest to be charged on payments outside credit terms.

Central Bank Enforcement

The Central Bank has published its Enforcement Priorities for 2013, highlighting the importance of enforcement within its risk-based regulatory framework. It will include areas of non-compliance identified during supervisory reviews. The priorities identified include three new areas in 2013 – (1) payment services regulations, (2) suitability requirements (Consumer Protection Code 2012), and (3) errors and overcharging.

The Central Bank has also published its planned series of themed reviews and inspections for 2013. In addition, it will also continue to conduct reactive inspections on key issues and themes as they arise throughout the year.

Micro Entities.

The UK BIS has issued a consultation paper – Simpler Financial Reporting for Micro Entities – which is a proposal to make changes to the companies Act 2006 and the Accounting Regulations under the Act. This is to implement the EU Directive on micro entities which provides exemption from certain financial reporting requirements otherwise applicable to small undertakings. Micro-entities are entities which do not exceed the limits of two of the following three criteria-balance sheet total €350,000, net turnover €700,000 and average number of employees 10 (or fewer).

Contacts

Our firm's website, www.iasplus.com, provides a world-leading continuously updated information source on international financial reporting developments and includes a link to our freely accessible IFRS eLearning programme

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