TO LEAD OR TO FOLLOW? THE TRANSITION TO NEW ACCOUNTING STANDARDS

Transition date is just around the corner! If you haven't already begun planning how to meet the challenges of moving to a new accounting framework, it's time to start sorting out what it means for you. **Brendan Sheridan** provides some guidance.

Entities will have a choice of framework between FRS 102 and IFRS and some may also have a choice of FRSSE or, indeed, FRS 101. A recent Deloitte survey of CFOs of Irish entities indicated that almost 60% of those surveyed had not decided on which accounting framework to use from 2015 onwards.

It is likely that the vast majority of Irish entities will be implementing FRS 102, the new *Financial Reporting Standard Applicable in the UK and Republic of Ireland* for periods beginning on or after 1 January 2015. Comparatives will be required and for calendar year end reporters this means transition date is 1 January 2014. If an entity is new, why bother with current Irish standards? If it is an existing company, why not meet the challenge head on and lead the way?

Insurers await completion of FRS 103, with implementation also intended for 2015.

LESS INK FOR SOME!

For IFRS groups, why not avail of the advantages of the FRS 101 'Reduced Disclosure Framework' and eliminate those page-filling disclosures in the parent only and subsidiary financial statements? While the conditions for being a 'qualifying entity', as defined in the standard, will have to be met, the ability to do this may extend to groups preparing financial statements other than under IFRS, where they meet certain conditions. Most people know that little or no value is to be gained from those copious disclosures in such areas as financial instruments and share-based payment. A reduced disclosure framework is also available for 'qualifying entities' under FRS 102.

Adopters of FRS 101 need to be aware that FRS 101 is not full IFRS and therefore financial statements must be prepared in accordance with Companies Acts formats which will also require some items to be treated differently than under IFRS.

Is it worth the effort? One expects it to be of interest to many, even if it involves more than a mere stroke of a pen through sections of the IFRS financial statements.

Some groups retained the use of Irish GAAP for preparing subsidiary financial statements. Now is decision time because change is unavoidable and the transition to either FRS 101 or FRS 102, or indeed full IFRS, needs to happen by 2015 at the latest.

THE SMALLER ENTITIES

FRSSE adopters can continue with the 'small entity' standard. There are some consequential amendments coming from the change to FRS 102. Keep an eye on developments coming from the changes in EU directives with the objective of simplifying the process for small and micro entities. Changes to Irish company law will be made in the next couple of years on foot of those developments. All companies need to be alert to these changes.

FINANCIAL INSTITUTIONS

Some are not so lucky with the 'reduced disclosure framework(s)' made available under the standards and will need to deal with additional disclosure requirements. They have avoided the imposition, which at one stage was being proposed for them as entities with fiduciary responsibilities, of preparing their financial statements in accordance with full IFRS. Many financial institutions already do use full IFRS, but the smaller classes of entity, including credit unions and friendly societies, will be spared the rigours of full IFRS. They will have to cope with the additional disclosures required of financial institutions by FRS 102, in addition to the recognition, measurement and disclosure requirements of FRS 102 as they apply to all entities.

The FRC's late change to include 'any other entity whose principal activity is to generate wealth or manage risk through financial instruments' in the definition of a financial institution certainly broadens the scope. It is perhaps a little unclear, particularly in group situations, as to

Table 1: Financial institutions – additional disclosures

Significance of financial instruments to performance and financial position on disaggregated basis
Reconciliation of impairment allowance account by class of financial asset
Amount of different classes of financial instruments carried at fair value by level of hierarchy
Nature and extent of credit, liquidity and market risks – risk exposure with objectives, policies and processes for managing exposure risk and related matters

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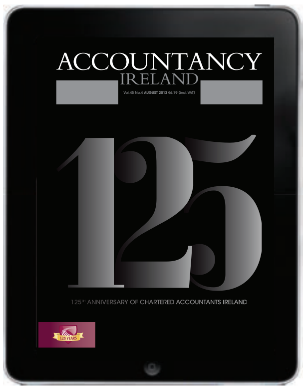
Table 2: Financial instruments – FRS 102 (general overview)

BASIC (SECTION 11) – EXAMPLES	COMPLEX (SECTION 12) – EXAMPLES
Cash and demand deposits	Derivatives e.g. forwards, swaps, options
Trade receivables and payables	Non-typical contracts to buy or sell a non-financial item
Debt instruments meeting certain conditions	Investment in convertible debt
Loan commitments settled net in cash	Loans with option to repay at fair value
Equity instruments e.g. quoted ordinary shares	Loans with interest linked to indices
Measurement: mainly at cost/amortised cost with the exception of publicly traded equity instruments.	Measurement: mainly fair value except for equity instruments where fair value cannot be reliably measured



whether certain entities fall within the definition and therefore have a heavier burden of disclosure.

THE CHALLENGES OF TRANSITION

So what is changing? There are many significant changes to accounting, including deferred tax, foreign currency, pensions, intangibles, investment property and a host of others. The general understanding is that for many the most significant change is the accounting for financial instruments. The degree to which companies will be affected depends on what is in their financial statements, the nature of business and complexity of transactions. This very quickly leads to one of the first steps in the process, which is the need to carry out an in depth review of the financial statements prepared under current Irish GAAP, identification of where changes are going to arise including disclosures, and ideally the preparation of *pro forma* financial statements in accordance with FRS 102. This exercise can be carried out now, why wait any longer?

FINANCIAL INSTRUMENTS – HOW WILL THE CHANGES IMPACT?

The impact of the introduction of the new standards as they relate to financial instruments will depend on whether IAS 39 or FRS 26 is being applied and whether you are moving to FRS 101 or 102.

Entities currently reporting under Irish GAAP, excluding FRS 26, are likely to face significant changes regardless of which of the new frameworks they adopt. While a move to FRS 102 seems the most likely, entities should bear in mind that an option is available to adopt IAS 39 or, indeed, IFRS 9 even before it is endorsed by the EU, with FRS 102 disclosures retained.

Financial instruments are dealt with in FRS 102 in Section 11 'Basic Financial Instruments' and Section 12 'Complex Financial Instruments'.

At the basic level…

For the majority of financial instruments commonly held by most companies, Section 11 is key as it deals with a range of commonly held assets and liabilities including cash, deposits, accounts receivable and payable and others. A major change to current accounting, with some exceptions where fair value measurement is required, is to require an amortised cost model for all basic financial instruments. This will not require any adjustment for the majority of assets and liabilities which are classified as current. The requirement to use amortised cost may lead to changes in accounting for loans and other debt instruments.

At a more complex level…

Section 12 of FRS 102 applies to other, more complex financial instruments and transactions. One of the largest impacts will be in relation to how an entity accounts for derivative financial instruments. Derivatives, currently held off balance sheet, unless applying FRS 26, will need to be recognised on balance sheet and measured at fair value. The gains or losses on these instruments will be taken to the profit and loss account except in cases where hedge accounting is applied. Common examples of these are forward contracts and interest rate swaps.

Hedge accounting requires entities to…

…formally designate, document and test the conditions required by transition date to ensure they are effective for the whole of the comparative period.

The good news is that recent proposed amendments to FRS 102 will update the requirements for hedge accounting on a basis consistent with IFRS 9 and FRS 102 will, as far as possible, use concepts and language consistent with IFRS 9. IFRS 9 requirements are less stringent than IAS 39, focusing on entities' economic and risk management strategies, including the removal of the 80% to 125% rule. Designation and documentation continue as conditions fundamental to being able to apply hedge accounting.

CONCLUSION

Change is on its way for the vast majority of Irish entities, while still others currently using IFRS may wish to avail of a reduced disclosure framework. 2015 is not far away and transition date is just around the corner, so the time to do the homework is now.

For the brave hearts, why not make the transition early? ■

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