FINANCIAL REPORTING ASB PROPOSES A NEW WAY FORWARD

A single standard of 250 pages to replace what has been described as an uncomfortable mish-mash of accounting standards of different origin that lack cohesion or unifying principles, and count some 2,500 pages. It's an attractive idea, but could it work? **Brendan Sheridan** takes a look at the latest proposals from the Accounting Standards Board.

For Irish entities that are not listed groups, at one end of the scale, or entities that either don't qualify for or have not availed of 'small company accounting' under FRSSE at the other, proposals published by the Accounting Standards Board (ASB) in January put forward a solution in the form of *The Financial Reporting Standard applicable in the UK and Republic of Ireland* (FRS 102). FRS 102 is one of three draft standards published by the ASB making up its proposed way forward for the future of financial reporting, with the others being FRS 100 *Application of Financial Reporting Requirements* and FRS 101 *Reduced Disclosure Framework*. Table 1 outlines the overall structure of the proposals.

The overall objective of the ASB is to enable users of accounts to receive high-quality, understandable financial reporting proportionate to the size and complexity of the entity and the user's information needs.

Some may see the ASB proposals for FRS 102 as being 'out with the new and in with the old' with, for example, dismissal of the extension of 'public accountability', together with the reinstatement of both Companies Acts formats and a number of accounting treatment options. The ASB has adopted a more pragmatic approach than was evident in their earlier proposals published in October 2010, when moving to IFRS for SMEs was all but the sole objective. The ASB continues to propose an IFRS-based approach, and IFRS for SMEs in particular, while retaining certain core elements of current GAAP.

The following paragraphs outline some of the main features of the proposals; however, readers are urged to visit the ASB's website to review documents and become familiar with proposed changes that may have a significant impact for a large number of Irish entities.[1]

CHANGING ENVIRONMENT

At international level, the IASB, working with the FASB, is developing new standards in response to the reporting challenges brought to the fore by the financial crisis, with IFRS 9 on financial instruments being a major topic. At European level, the EU is currently addressing its objective of creating a framework for more cost-efficient accounting by small and micro entities,

Table 1: ASB's Proposed Structure for Reporting

	EU adopted IFRS	Reduced disclosure available? (FRS 102)	FRS 102	Reduced disclosure available? (FRS 102)	FRSSE
Listed					
Group consolidation	Mandatory	No			
Parent/ subsidiary	Option	Yes	Option	Yes	
Individual entity	Option	No	Option	No	
Unlisted large/ medium					
Group consolidation	Option	No	Option	No	
Parent/ subsidiary	Option	Yes	Option	Yes	
Individual entity	Option	No	Option	No	
Unlisted small					
Entity/group	Option	No	Option	No	Option

proportionate to their needs, with by far the greatest number of European companies being in that category. The ASB has indicated that it will respond to any significant changes, with additional exposure drafts to align with IFRS 9, and amendments to FRSSE when the EU position is clear.

CHANGES TO EARLIER PROPOSALS

Some of the main changes between the October 2010 and the January 2012 proposals for FRS 102 are:

- Accounts formats in accordance with company law, with requirement extended to all reporting entities unless other legal /regulatory requirements apply.
- Accounting treatment options, consistent with EU-adopted IFRS, in the following areas:
  - Revaluation of property, plant and equipment and intangible assets;
  - Capitalisaton of borrowing costs;
  - Carrying forward development costs;
  - Recognition of grant income on a systematic basis over the life of the assets;
  - Merger accounting permitted for group reconstructions;
  - Hedge accounting permitted for net investments in foreign operations.
- Consolidation requirements updated and certain relief provided for investments in subsidiaries held as part of an investment portfolio.
- Revised proposals for accounting for taxation – largely based on current Irish GAAP, with requirements included to provide for deferred tax on revaluation surpluses and fair value adjustments arising in business acquisitions – approach based on timing, not temporary differences.
- Accounting requirements for retirement benefit plans.
- Entities listed but not traded on a regulated market are directed to EU-adopted IFRS in relation to earnings per share, interim financial reporting and operating segments.
- For entities engaged in insurance business, the ASB directs them to the appropriate IFRS standard on insurance contracts – IFRS 4.

A number of additions have also been made in the draft FRS 102 to provide clarification

Table 2: Irish GAAP to FRS 102 Changes

Topic	FRS 102	Irish GAAP
Acquired goodwill and intangibles	Amortisation, assumed over 5 years where useful economic life cannot be reliably estimated.	Amortisation over assumed maximum life 20 years.
Investment entities	Fair value through profit and loss (FVTPL) allowed where interest in the subsidiary meets the widened definition of 'held exclusively with a view to resale'.	Investment companies unlikely to be exempt from consolidating subsidiaries.
Share based payments	Relaxation on need to use option pricing model where appropriate to the circumstance of the entity.	Option pricing model must be used.
Multiemployer pension schemes	No exemption from defined benefit accounting in individual accounts where entities in the scheme are under common control.	Wider exemption is available to group entities.
Financial instruments	In general, 'basic' financial instruments at cost, and 'complex' instruments e.g. derivatives, at FVTPL, limited hedge accounting permitted, no 'synthetic instrument accounting' e.g. floating swapped to fixed rate, option to use full IFRSs.	Comparatively few rules on financial instruments. Derivatives often 'off balance sheet'. Some use full IFRS accounting (FRS 26).
Investment property	Use cost unless fair value can be measured reliably without undue cost or effort, in which case use FVTPL.	Mandatory revaluation to open market value through Stg£.
Income Tax	'Timing difference plus' approach used.	Deferred tax calculated using a timing difference approach.
Foreign currency	Transactions recorded in functional currency, not able to use contracted rate.	SSAP 20 *Foreign Currency Translation* uses local currency.

by reference to EU-adopted IFRS that should avoid unnecessary diversity in practice.

COMPARISON WITH CURRENT IRISH GAAP

Table 2 summarises some of the main proposed changes, with, perhaps, financial instruments being of most common significance. For many under current Irish GAAP, certain transactions remain unrecognised, off balance sheet, that are relevant to the financial position of an entity. Accounting for derivatives and fair value measurement are areas where current GAAP has fallen out of line and behind the methods being used to transact financial transactions in today's markets. A typical example may be where a company hedges its foreign currency exposure on sales to non-Euro markets. FRS 102 will require the underlying debtor to be translated using the current rate, not the hedging contract rate as currently applies, and to recognise the fair value of the hedging instrument. This is a new accounting discipline which will take time and attention to become familiar with.

Even at a more basic level, for entities with bank loans which have a maturity profile of more than one year, they will have to adopt the amortised cost model in measuring the liability at each accounting date, and the interest charges in the profit and loss account. While this may not change amounts to be reported for straightforward banking arrangements, it is different accounting and changes may arise.

REDUCED DISCLOSURE FRAMEWORK

The ASB proposes a reduced disclosure framework (RDF) for qualifying entities within groups which would extend to all group companies, subsidiaries and parent company, provided they are included in consolidated financial statements that give a true and fair view, and are publicly available. This will be welcomed by Irish groups and the large numbers of subsidiaries of multi-nationals that have invested in Ireland. RDF is available to groups adopting IFRS, or equivalent framework, with a wide range of disclosure exemptions available (see Table 3).

Table 3: Reduced Disclosure Framework – Qualifying Entities

(Group financial statements – prepared in accordance with IFRS)	
Share-based payment – option values	Comparative Information ➤ Property, plant and equipment ➤ Intangible assets ➤ Investment property
Acquisition of businesses	Discontinued operations
Financial instruments*	Presentation of Financial Statements ➤ Statement of changes in equity ➤ A statement of financial position at beginning of earliest comparative period where there is a retrospective change in accounting policy or other restatement
Fair value measurement*	Capital management
Contractual commitments for acquisition of property, plant and equipment	Statement of cash flows
Compensation of key management personnel	New accounting standards issued but not yet effective
Related party transactions between wholly owned subsidiaries	Impairment – underlying assumptions

*Not available to financial institutions

RDF is also available to those adopting FRS 102 where exemptions include cash flow statement, share option valuations, fair value of financial instruments and a number of others. RDF is not available to any entities which choose to, or are required to, prepare consolidated accounts.

A qualifying entity which is a financial institution may not avail of exemptions from the disclosure requirements of IFRS 7 *Financial Instrument: Disclosures* and IFRS 13 *Fair Value Measurements* or the equivalent requirements of FRS 102.

Companies using RDF are subject to Companies Acts accounts formats and requirements which may lead to some anomalous positions on adoption.

FINANCIAL INSTITUTIONS

The ASB has recognised the significance, complexity and risk nature of the activities of financial institutions. While recognition and measurement requirements are considered to be adequately dealt with, the ASB has added specific disclosure requirements for financial institutions which are aligned with the principles of IFRS 7 *Financial Instruments: Disclosures*.

The ASB has also defined the scope of financial institutions, from the large bank or insurer to the local credit union, across the range. They will no doubt welcome that they are not mandatorily required to adopt EU-adopted IFRS under the new proposals, unless they are listed.

CONCLUSION

The draft standards are open for comment until 30 April 2012 and, unless there is very substantial discontent expressed in the comments which takes considerable time to resolve, it may be expected that the final standard will be published by the end of 2012. All going well, the standards will be available for early adoption in 2013 with mandatory implementation for 2015. ■

Notes

[1] www.frc.org.uk/asb/press/pub2702.html

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