BY
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FRS 102: Last Chance Saloon!!

As the 1st January 2015 approaches Robert Kirk summarises the key changes to expect from the implementation of the new accounting standard replacing Irish & UK GAAP, FRS 102.

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The CPA Ireland Certificate in FRS 102 will take place again (including a London venue) in January 2015. Visit www.cpaireland.ie/certificate-in-frs-102 for further information.

From the 1st January 2015 all companies in Ireland will be reporting under the new reporting regime instigated by the Financial Reporting Council (FRC). For most it means switching from local SSAPs and FRSs to FRS 102 based on the recognition and measurement rules of international financial reporting standards.

In this article I would like to take the opportunity of reminding readers of the main differences and risks that you will face on the introduction of the new standard.

Concepts and Principles

This is the first standard that has actually encompassed the basic concepts and principles within an accounting standard. Previously these were always recorded in separate documents as an aide memoire to standard setters to ensure they could derive consistent standards.

As the principles are now enshrined in a standard it means that when companies encounter difficulties in deciding how to account for a transaction and they are unable to find the solution in the other 34 sections then they must refer back to Section 2 of the standard to try and find the appropriate accounting solution. They are allowed to go into full IFRSs eventually if they wish but only after consulting Section 2 first. That means that nearly all unusual accounting transactions should be sorted out through Section 2 and in particular the key decisions as to whether a debit is an asset or an expense and whether a credit is an income or liability and if they should be recognised in the financial statements. Section 2 will play a key role in the application of the new standard.

The Primary Statements

FRS 102 incorporates five primary statements, some new and some considerably amended from old GAAP. In particular, preparers will need to look carefully at the layout of the balance sheet to include headings for both current and non current assets and liabilities. The profit and loss account will be prepared largely in the same manner as before but its sister performance statement, the Statement of Total Recognised Gains and Losses (STRGL) now becomes the Statement of Comprehensive Income instead, albeit largely the same. The Cash Flow Statement is now compulsory, apart from subsidiaries, but with a very different layout. There are only three headings in that document compared with nine in the previous local standard FRS 1. That will require more judgment by preparers in deciding where to analyse cash flows between operating, investing and financing activities. A brand new Statement of Changes in Equity will be required showing the movement in capital and reserves for two years. This will incorporate prior period adjustments, transfers between reserves, total comprehensive income, dividends paid and new capital raised et al.

In addition for many small entities, particularly those who currently do not publish a STRGL, there will be a new option to publish a Statement of Profit and Retained Earnings and be exempt from the other performance statements and the Statement of Changes in Equity as well. This is really very similar to what was called in the past a Profit and Loss Appropriation Account.

The only template available is that published by the FRC in their Staff Education Notes for a Cash Flow Statement so undoubtedly there will be some experimentation taking place in the layout of the primary statements but readers should be aware that companies will still have to comply with the layout under the Companies Act.

Assets

FRS 102 permits companies to adopt either an historic cost or fair value approach to valuing property. Companies that are currently using the revaluation model may, at transition, opt for a deemed cost approach and cease revaluation but also companies who currently do not revalue could undertake a once off valuation at transition to bring their asset values and reserves up to date and then also cease any further revaluation. However, this has to be carried out at the date of transition – for most companies with December year ends, the 1st January 2014.

Preparers will also have to consider whether or not to capitalise development costs and to capitalise borrowing costs on the construction of a property or maturation of their inventories but that is also available under current Irish GAAP.

Some companies with very large pieces of plant and equipment will have to consider whether they need to be broken down into separate components and depreciated over different lives. That was always an option under local GAAP but is now compulsory.

There is also a possibility that companies may decide to cease depreciation of their buildings on the grounds of high residual values. That is because the definition of the depreciable amount of an asset has changed as previously residual values were only calculated on the first day of acquisition of a piece of equipment but now they must be regularly revalued.

There are no major changes on intangible assets apart from acquisition activity. If a business combination occurs during the year companies are now expected to invent as many intangible assets as they can and effectively call goodwill by another name but they do have to be separable from goodwill. Examples in the PLC sector to date have included assets such as customer lists, non-contractual customer relationships, volunteer lists, brands, mastheads etc. These then should be amortised over their useful lives but with a maximum write off period of 5 years if the company is unable to find a reliable estimate of those lives.

Goodwill, however, will pose problems. It must be calculated from now on as merger accounting has been abolished by FRS 102 and therefore only acquisition accounting will be permitted. At transition, it could be argued that, although the standard has a maximum 5 year write off period if no reliable estimate can be made of the useful life of goodwill, under the transition rules no change in accounting estimate can be made and therefore companies might be able to finish off their normal 20 year write off period carried out under local GAAP.

The only change to look out for in inventories is the ability, under FRS 102, to reverse a previous impairment if the circumstances which caused the impairment have reversed. However, the rules of carrying inventory at the lower of cost and net realisable value have been maintained and the costs to include in getting the inventory to its present location and condition have also been retained. It should be noted however that LIFO is not permitted.

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Grants

One very interesting new development in FRS 102 has been the introduction of an option to adopt the performance model rather than the traditional accruals model in accounting for government grants. The performance model is based on getting the balance sheet right by insisting that grants be reported in income as the company performs under the contract with the grant aiding authority rather than trying to match the grant income with the related depreciation charge. If companies adopt this model it will undoubtedly result in earlier recognition of grants within income.

Liabilities

There are no real major issues with liabilities apart from the issue of deferred tax. Under FRS 102 it will be a requirement to include deferred tax liabilities on potential capital gains tax on the revaluation of properties as well as in the fair value exercise undertaken on a business combination.

Although there are different definitions of a finance lease as between SSAP 21 and FRS 102 it is unlikely that companies will have to restate their classification of current leases. However, when disclosing the liabilities owed to their lessors under operating leases companies will have to disclose their total liability to the end of the contract and not just the annual operating lease commitment. This will undoubtedly highlight the huge amount of borrowing undertaken through operating leases. Once the new full IFRS standard on leases is published in 2015 it is likely that these liabilities will eventually have to be reported on the balance sheet when FRS 102 is subsequently revised.

Performance Measurement

There are unlikely to be many problems in implementing the performance measurement sections. Accounting for share options and pension schemes are largely the same although those companies not accruing presently for holiday pay will have to create a new provision at transition.

There is a section on revenue recognition and although there is no local standard on the topic it should not pose problems as the accounting recommended would be similar to that currently used in practice.

Financial Instruments

This is one area where there could be problems on implementation. Although the topic is broken up into two sections – one dealing with basic and the other with more complex transactions – there will a number of significant changes.

If companies decide to offer their customers long term credit then effectively the price they have agreed with their customer is a mixture of sales income and interest income. This will require companies to discount long term receivables to present value the sales income and the associated receivable. That discount will then unwind and will create interest income up to the date when it is due as well as increasing the receivable to the amount due to the company. This is all part of the implementation of an effective interest rate model for financial instruments.

For those companies involved in derivative activity then the accounting will become more complicated as this will require new assets and liabilities to be reported on balance sheet for those instruments and to be measured at their fair value with gains and losses being reported in profit.

Foreign Currency Translation

Although there are no changes required for foreign currency transaction accounting some companies may find the new rules on translation to be a key issue on transition. Companies will have to keep their books and records in their functional currency i.e. the currency of the primary economic environment in which the company operates. That may not necessarily be their domestic currency and therefore will require consideration of a number of factors such as the currency in which sales are made, purchases incurred and wages paid as well as to the source of financing for the company and how it banks its receipts from other currencies. The temporal method under SSAP 20 has now gone and so some companies may have to substantially alter their bookkeeping records.

Specialised Activities and Public Benefit Entities

FRS 102 has introduced a number of specialised activities into Section 34 of the standard covering such diverse subjects as accounting for heritage assets, agriculture, service concessions i.e. PPP contracts, additional disclosure for financial institutions and the broad content of pension scheme accounts.

In addition, there are a number of sections which only public benefit entities can adopt i.e. not for profit entities. Unfortunately for most of these entities there are or will be additional rules published in individual Statements of Recommended Practice (SORPs) by the 1st January 2015 which will mean that more than one document will have to be read in preparing the annual financial statements. These include charities and further and higher education entities.

Conclusion

Although the 1st January 2015 is the date from which financial statements must be prepared under the new standard there are requirements to publish three reconciliations to bring the old GAAP of 2014 up to FRS 102 – included in the notes to the 2015 financial statements. These require two reconciliations of capital and reserves (equity) as at the 1st January and 31st December 2014 and a reconciliation of profit for the year ended 31st December 2014.

There is certainly a fair amount of work to be undertaken over the next few months to ensure a smooth transition not the least of which is ensuring that the software programmes are up to date and that staff are adequately trained on FRS 102.

In the authors opinion, however, there will be major benefits in the medium to long term for companies preparing their financial statements under FRS 102.

Get up to speed with FRS 102 in 2015

CPA Ireland will run a series of events on FRS 102 throughout 2015. Further details can be found on page 47 and on www.cpaireland.ie/cpe.