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A new era for Irish & UK GAAP

A quick reference guide to FRS 102

The Institute of Certified Public Accountants in Ireland

Robert J Kirk CPA, FCA

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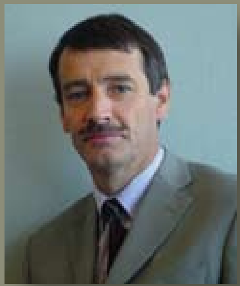
About the Author



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Professor of Financial Reporting, University of Ulster

After graduating with a second class first division honours degree in Economics from Queens University, Belfast in 1972 Robert trained as an Irish Chartered Accountant with Price Waterhouse, qualifying in first place in his final examinations in 1975. Subsequently he was employed as the Financial Controller of ICB, a subsidiary of Shell (UK) and as a personal assistant to the partners in James Baird & Co (now part of PricewaterhouseCoopers). In 1981 he was appointed a Director of Business and Accounting Training where he embarked on his academic career, teaching mainly on the professional examination courses for ICAI, CPA, CIMA and ACCA in Belfast and Dublin. In 1985 he joined Queens University as a full time lecturer and moved to the University of Ulster in 1992 as a Senior Lecturer. In 1994 he was appointed to the Chair in Financial Reporting at Ulster.

Robert specialises in the teaching of and research into the development of accounting standards in the United Kingdom. He has published 15 books and numerous articles in both academic and professional journals. Three of his publications are currently core textbooks for two of the main professional accounting bodies in the United Kingdom. He has lectured extensively within Ireland and Great Britain on the subject of accounting standards and has become the main CPE speaker in that field over the last ten years for The Institute of Chartered Accountants in Ireland (ICAI), The Chartered Institute of Management Accountants (CIMA) and the Institute of Certified Public Accountants in Ireland (CPA). He also lectured on several occasions for The Chartered Institute of Public and Finance Accountants (CIPFA) and The Chartered Association of Certified Accountants (ACCA).

In his period at Queens University he was the Director in charge of the Diploma in Accounting set up under the auspices of the ICAI and of the Final Admitting Programme of that institute. Robert has also played an important role within the committee structures of his own Institute since qualifying and currently is a member of the Accounting Committee which promulgates accounting standards in the Republic of Ireland. He is also a judge on the Leinster Society of Chartered Accountants Published Accounts Awards Committee. Until 2004 he was the chief examiner for the final Advanced Financial Accounting paper towards the CPA qualification and he has previously served in a similar role in financial accounting for the ICAI. He became an associate member of The Institute of Certified Public Accountants in March 1997.

He has been an external examiner for Dublin City University, Griffith College Dublin, the Institute of Technology in Athlone and for the British Consortium for Higher Education in Malaysia. He has served on the Academic Board of CIPFA's national education and training centre and is currently on the Academic Board of The Institute of Certified Public Accountants in Ireland (CPA). He has also been a member of the Accounting Committee of Chartered Accountants Ireland for over 10 years whose role is to communicate the views of that body of proposed changes in accounting standards to the International Accounting Standards Board (IASB) and the Accounting Standards Board (ASB).

His social interests include playing veteran league and tournament tennis for the Belfast Boat Club, occasional golf and collecting old football and rugby programmes. He has also been very keen on quizzes and authored the Ulster Trivia Quiz Book published by Appletree Press in 1990.

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Introduction

A New Era for Irish & UK GAAP - A quick reference guide to FRS 102

After many years of debate, review, consultation and exposure drafts the Financial Reporting Council (formerly the Accounting Standards Board) has finally published FRS *102 The Financial Reporting Standard applicable in the UK and Republic of Ireland* in March 2013.

This new standard will replace extant Irish & UK GAAP accounting standards (i.e. SSAPs and FRSs) for accounting periods commencing on or after 1st January 2015 (with major transitional arrangements from 1st January 2014).

Early planning will be critical to a smooth transition. Now is the time for all CPAs currently implementing Irish & UK GAAP to familiarise themselves with this new Standard. With this in mind CPA Ireland has produced the following Quick Reference Guide to FRS 102 encompassing FRS 100 'Application of Financial Reporting Requirements' and FRS 101 'Reduced Disclosure Framework'.

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President's Foreword

I am delighted to present *A New Era for Irish & UK GAAP - A quick reference guide to FRS 102*. This is CPA Ireland Skillnet's first publication on the new FRS102 incorporating FRS100 and 101. Taking effect from 1st January 2015, this new standard will replace Irish & UK GAAP accounting standards.

CPA Ireland Skillnet and Robert Kirk have worked to bring you this quick reference guide as your 'go to' information resource for FRS102. Each chapter is clearly laid out and addresses the various sections of the standard in a comprehensive manner. This publication is a must for CPAs currently using Irish & UK GAAP who must now gain extensive knowledge on what is the future of Financial Reporting in Ireland. The Institute's technical team is also on hand to support CPAs in their understanding of this new standard. Please feel free to contact a member of the technical team with any queries you may have.

I would like to thank the author Robert Kirk for his continued support of CPA Ireland and for producing such a comprehensive and informative publication which will act as an essential reference guide for CPAs and accountants throughout Ireland.

Joe Aherne

President CPA Ireland

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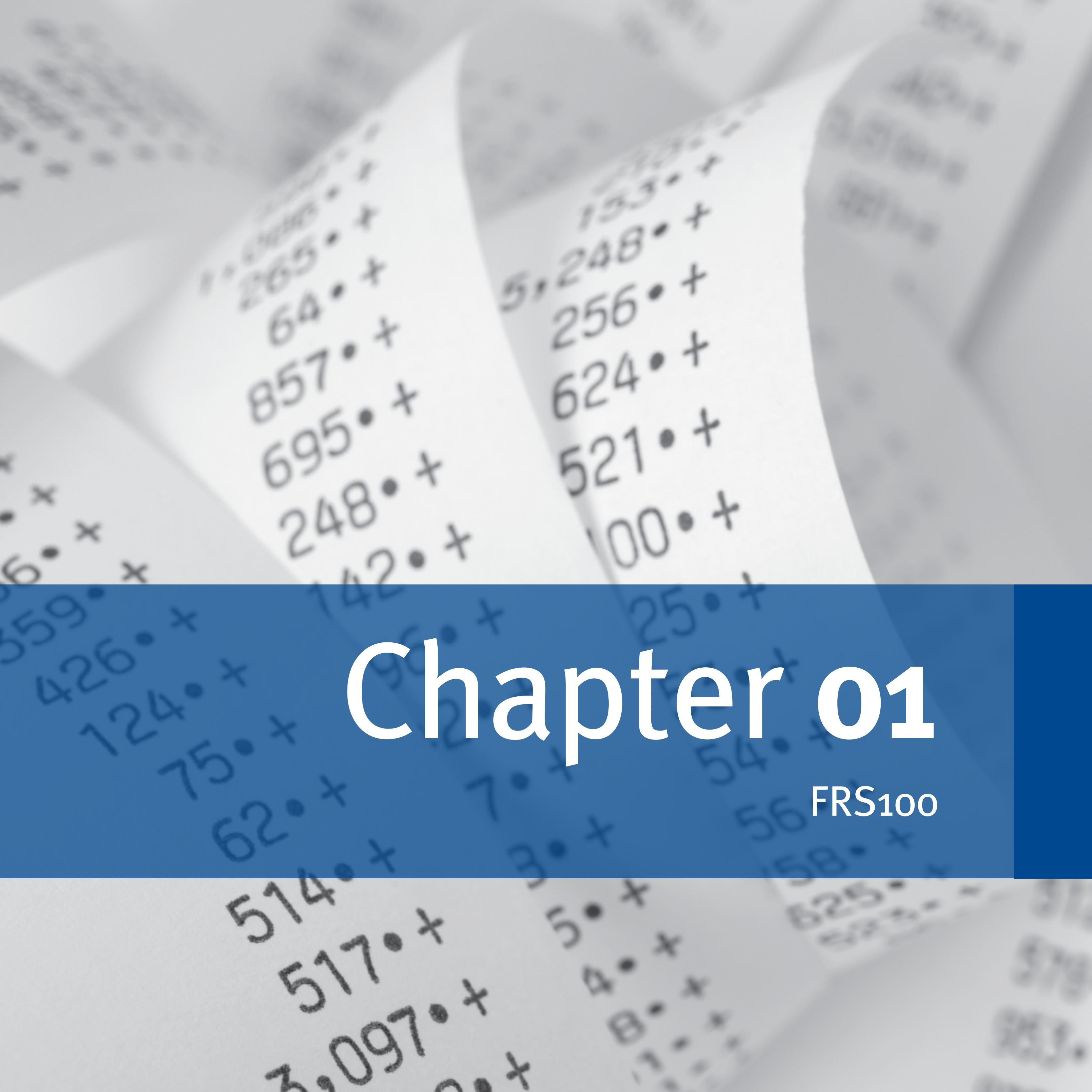
Contents



Chapter 01

FRS100

Background

In July 2009 the International Accounting Standards Board (IASB) published the International Financial Reporting Standard for Small and Medium Sized Enterprises (IFRS for SMEs) which could be applied to all non-publicly accountable reporting entities throughout the world. It consisted of approximately 200 pages, considerably less than the full IFRSs. Although the standard has already been adopted in a number of countries it is up to each jurisdiction to decide to whom it should be applied and when. To date over 60 countries have adopted the standard but because largely of legal difficulties within the European Union (EU) the UK and Republic of Ireland (ROI) required a more tailored approach to ensure that the standard was acceptable to EU law and met the specific needs of users in these islands. As a result there are considerable differences between the IFRS for SMEs and the UK/Irish version "FRS 102 - The FRS applicable in the UK and Republic of Ireland".

The standard replaces local accounting standards (i.e. SSAPs and FRSs) for accounting periods commencing on or after 1st January 2015 (with major transitional arrangements from 1st January 2014) and thus there is an urgent need for CPAs to get to grips as soon as possible with the likely changes that will impact on their work.

Scope

In the UK/Irish version the definition of who will be entitled to adopt FRS 102 is different from the IFRS for SMEs. FRS 102 simply permits all non-listed companies to adopt the new standard but also permits smaller entities to retain or apply the Financial Reporting Standard for Smaller Entities (FRSSE). It is possible that this may only be a short term measure and over time the FRSSE may be abolished. Much will depend on the EU's current project on small companies which may result in a considerable reduction in reporting for those entities passing the small entity criteria.

There are three separate documents published:
FRS 100 Application of Financial Reporting Requirements
FRS 101 Reduced Disclosure Framework
FRS 102 The FRS Applicable in the UK and Republic of Ireland

FRS 100 merely sets out the new financial reporting framework as follows:

Reporting Entity	Current Position	New System	
Small Entity	Option of FRSSE or full FRSs/SSAPs	Option of FRSSE or FRS 102	
Non listed company	FRSs/SSAPs	FRS 102	Reduced disclosure for parents and subsidiaries
Listed company *(Consolidated accounts)*	Full IFRS	Full IFRS	Reduced disclosure for parents and subsidiaries

FRS 100 also spends some time defining certain entities:

A **public benefit entity** (see separate chapter 10 for special additional requirements).

A **financial institution** (if not listed will be able to adopt FRS 102 but they require additional disclosure contained in Section 34 of FRS 102).

A **qualifying entity** (parent and subsidiaries of listed companies – who can avail of the reduced disclosure framework in FRS 101 – see Appendix 1 for details).

FRS 100 has decided to retain the not for profit Statements of Recommended Practice (SORPS) but abolish the rest. These SORPs have been updated by the relevant SORP making body to ensure they are IFRS compliant (e.g. Charities SORP, Housing Associations SORP etc).

All reporting entities preparing their financial statements under FRS 102 will have to provide a formal Statement of Compliance with FRS 102 in their financial statements, probably in their accounting policy note.

FRS 101 was introduced into the UK and Ireland to help parent companies and subsidiaries from having to comply with the very extensive disclosure required under full IFRS but at the same time avoid unnecessary consolidation adjustments if they were to adopt FRS 102. It is likely therefore that most subsidiaries of listed companies will avail of this exemption – they will prepare their financial statements using the recognition and measurement rules of full IFRS but at the same time reduce their disclosures by availing of the substantial exemptions in FRS 101.

Essentially there are five major differences between full IFRS and the new standard to make the preparation of financial statements of non-listed companies easier to understand and less expensive to prepare as follows:

1. The elimination of irrelevant topics such as earnings per share, segment reporting and interim reporting. If companies want to voluntarily prepare these documents they must follow the full IFRS standards i.e. IAS 33, IFRS 8 and IAS 34 respectively.
2. The elimination of options regarded as not cost beneficial e.g. the elimination of proportionate consolidation for joint ventures.
3. The simplification of recognition and measurement rules e.g. goodwill will be permitted to be amortised.
4. There will be a substantial reduction in the disclosure requirements from the full IFRSs (approximately 80% reduction).
5. A more straightforward drafting has made the document fairly understandable and easy to read and apply.

Section 2

Concepts and pervasive principles

Section 2 *Concepts and pervasive principles* of FRS 102 covers the basic concepts and principles in financial reporting. Unlike the full IFRS or local accounting standards, for the first time, these are now enshrined in the standard itself. In UK/Irish GAAP and in IFRS the basic principles have always been included in a separate document from the standards themselves *(Statement of Principles and Conceptual Framework respectively)*. This, in my view, places a greater priority on their adoption and Section 10.5 of the standard requires reporting entities to follow the principles in Section 2 for accounting transactions if their accounting treatment cannot be clarified either by the other sections of the FRS or within a relevant SORP. That effectively means there is no need to refer to full IFRS to try and find the correct solution to particular accounting transactions – they should all be solved by simply following the concepts and principles in Section 2.

It is possible, however, that there could be inconsistencies between the concepts and principles in Section 2 and the specific requirements of another Section. In that case the other Section's requirements prevail.

Objective of Financial Statements

Section 2 first covers the objective of financial reporting and demands that users are provided with information in the financial statements about the performance of the company, its cash flows and its financial position which would be useful for decision making purposes. In addition it must also help to ensure that management is properly accountable for their stewardship of the company's resources.

Financial reporting therefore is only useful if it helps to predict the future or confirm what has happened in the past.

Qualitative characteristics

Similar to both the Statement of Principles in the UK/Ireland, and the Conceptual Framework published by the IASB, this section sets out the qualitative characteristics that should underpin the financial statements. These should be at the forefront of every accountant's mind when selecting and applying the most appropriate accounting policies for their company:

Understandability

The information must be presented to make it as understandable as possible to non accountants but assumes they would have a reasonable knowledge of business. However, relevant information should not be omitted solely on the grounds of it being too hard to understand and that is why the complex rules on derivatives are still contained in Section 12 Other Financial Instruments Issues.

Relevance

The information provided must be relevant to decision making for users i.e. it must help to confirm the past or predict the future.

Materiality

Accountants only deal with material items as they generally are those with most relevance but it is always difficult to decide what is material. It must always be judged in the particular circumstances of each situation.

Reliability

The information must be free from both bias and error and faithfully represent the underlying transactions. Users must have faith in what is being presented to them.

Substance over form

If the legal form of a transaction does not reflect its commercial reality the accountant must override the legal form and apply the substance of a transaction. For example, a convertible loan is not just a liability as it has elements of equity through its conversion option. FRS 102 therefore, under Section 11 Basic Financial Instruments, requires reporting entities to split the initial proceeds on issue between both debt and equity elements.

Prudence

Although fairly demoted in recent years prudence or conservatism is still important in assessing whether an asset can be reported on the balance sheet but liabilities should not be deliberately overstated. Section 21 Provisions and contingencies will therefore not permit a mere intention to pay another party as a provision. It has to be a genuine legal or constructive obligation.

Completeness

Within the bounds of cost the information must be complete in order to make it reliable.

Comparability

Information on its own is not useful. It needs to be compared with previous years or with other companies in the same sector so any change in accounting policy needs to be reflected by restating not only the previous period's figures but also adjusting prior period reserves in line with the new policy.

Timeliness

Financial statements are historic documents so in order to make them useful for decision making they need to be published as quickly as possible but that conflicts with reliability and a balance therefore needs to be struck between the two characteristics.

Balance between benefit and cost

The benefits of providing financial information must always outweigh the costs of producing that information but the benefits need to be assessed carefully as they are difficult to evaluate e.g. improved access to capital, favourable effect on public relations, better management decisions etc.

Financial Position

This part of Section 2 really explains the content of the balance sheet and makes it clear that equity is the residual left over once the liabilities of the reporting entity are deducted from the assets of the business. The key elements are defined as follows:

- **Asset** Resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
- **Liability** Present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits.
- **Equity** Residual interest in the assets of the entity after deducting all its liabilities.

Assets and liabilities are not recognised on the balance sheet simply if they pass the definitions above. They also need to be able to pass the following two recognition tests:

(a) Is it PROBABLE that future economic benefits will flow into or out of the entity respectively?; and

(b) Can the asset or liability be reliably measured?

On the asset side expenditure on advertising, research, maintenance etc would all fail the probability test and similarly expenditure on internally generated assets such as building up a brand name would fail the second test. However, the right of ownership is not necessary for an asset to be created. This leads at present to finance leases being reported as assets on the balance sheets of lessees and probably if current developments on leasing are finalised by the IASB (ED *Leases* August 2010) to all leases being reported eventually on balance sheet in the next few years.

On the liability side there needs to be either a legal or constructive obligation (i.e. a pattern of past practice or current statement and a valid expectation of it occurring) and not a mere intention of paying before a liability can be created. In addition the probability criteria would mean that contingent liabilities would not be able to appear on the balance sheet e.g. a contested court case. Normally liabilities are settled by cash, the transfer of other assets or the provision of services but they could be extinguished by other means e.g. creditor waiving rights, conversion of convertible debt into equity etc.

Even if an asset or liability fails either of the recognition tests above they may still warrant disclosure as contingent assets and contingent liabilities. An example of the latter would be a proposed dividend which is not an obligation at the reporting date but shareholders would like to know what their dividend is likely to be after the AGM takes place. Similarly a contested court case could ultimately result in substantial damages to the company if it loses the case even if the lawyers are fairly confident of winning it and thus it should be disclosed in the notes to the financial statements to warn users of that possibility of potential loss.

Effectively this means that the most important document in the preparation of the financial statements is the balance sheet as gains and losses can only be reported if assets or liabilities change.

Performance

Income and expenses are split up into two types but in all cases they represent changes in the balance sheet from the start to the end of the reporting period apart from those relating to contributions or distributions with equity holders (e.g. new capital introduced, dividends paid out). In other words an increase in assets or a decrease in liabilities is a gain and a decrease in assets and an increase in liabilities is a loss during an accounting period.

Income consists of revenue created in the ordinary course of business (sales, fees, commissions, rents etc) as well as gains (e.g. profits on disposal of assets) and expenses consists of expenses created in the ordinary course of business (administration costs, depreciation, staff costs etc) and losses (e.g. losses on disposal of assets).

Normally gains and losses are presented separately in the statement of comprehensive income because knowledge of them is useful for making economic decisions.

Measurement

This is the process of determining the monetary amounts at which an entity measures the elements described above. Different Sections of FRS 102 do specify which method to adopt but the two main methods are historic cost and fair value and in a number of sections, an option is provided between the two methods:

- **Historic cost** Amount of cash or fair value to acquire an asset or, for liabilities, the amount of proceeds of cash received or fair value of non-cash assets received in exchange.

- **Fair value** Amount an asset could be exchanged for or liability settled between knowledgeable, willing parties in an arm's length transaction. Further guidance is provided in Section 11 on how it should be applied.

Initial recognition

Assets and liabilities are measured at historic cost unless FRS 102 requires an alternative basis such as fair value.

Subsequent measurement

Financial assets and liabilities

These are governed by Section 11 Basic Financial Instruments of FRS 102 and are required to be measured at amortised cost less impairment except for a couple of unusual instruments (non-convertible and non-puttable preference shares and non-puttable ordinary shares that are publicly traded) which are fair valued with changes being reported in profit and loss.

However, any financial instruments initially designated as at fair value through profit and loss should also be fair valued.

Non-financial assets

These are mostly recognised at historic cost but FRS 102 (unlike the IFRSSME) offers an option to revalue property, plant and equipment and both standards require fair values for investment properties and agricultural assets, if reliably measured. In addition, assets have to be reviewed for impairment and thus inventories must be reduced to their lower of cost and selling price less costs to complete and sell. Property etc. under the cost model must be reduced to its recoverable amount.

Non-financial liabilities

Most liabilities are measured subsequently at their best estimate of the amount required to settle those obligations at the reporting date.

Other Principles

Accruals basis

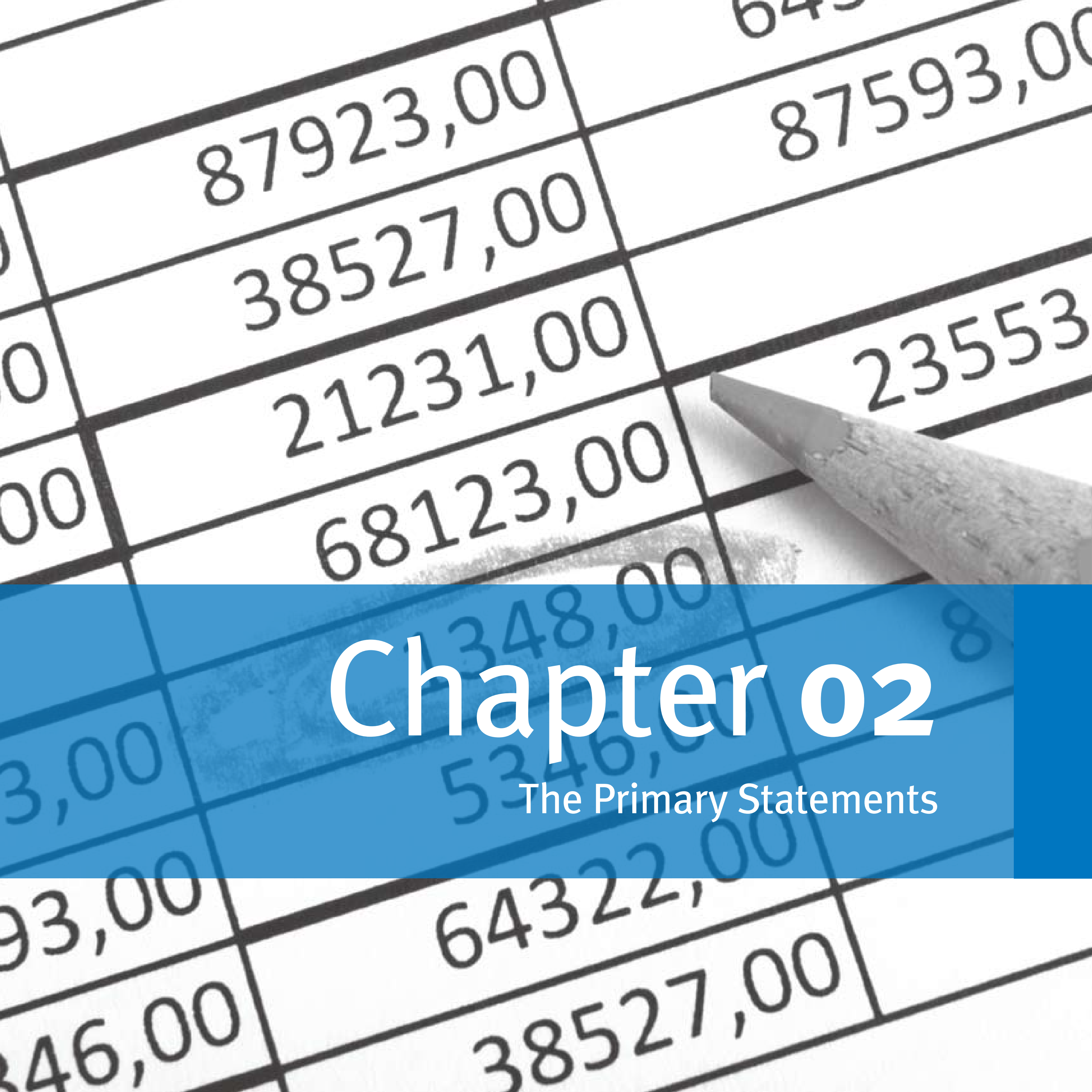
FRS 102 does cover the accruals principle and argues for its adoption except in cash flow statements and therefore, provided they also meet the definition of assets or liabilities, recognises transactions in the period when they occur and not when cash is received or paid.

Offsetting

Assets and liabilities are not permitted to be offset nor income and expenses unless permitted by FRS 102. However, allowances for bad debts and inventory are not regarded as offsetting. Similarly the netting off of book values against the proceeds on selling an asset in order to calculate a profit or loss on disposal is not regarded as offsetting.

Conclusion

FRS 102' s inclusion of the basic principles and concepts of financial reporting as an inherent part of the standard is a welcome innovation. It makes it more likely that the standard will indeed be a genuine standalone document. There should be no need to refer to any other standards outside FRS 102 in deciding on the most appropriate accounting treatment. Accountants must now refer to these principles first before going elsewhere but, in the writer's opinion, the vast majority if not all of the unusual accounting transaction problems should be resolved by simply following the principles in Section 2.



Chapter 02

The Primary Statements

Section 3

Financial Statement Presentation

This chapter of FRS 102 incorporates the basic principles essential for a fair presentation of the financial statements including the going concern assumption, consistency of presentation, comparability and materiality. It demands also that there should be an unreserved and explicit statement of compliance with the FRS. However, it clearly states that a complete set of financial statements should include each of the following primary statements for the current period and for the comparable period:

- Statement of Financial Position (i.e. the balance sheet)
- Statement of Comprehensive Income (single document) or an Income Statement and separate Statement of Comprehensive Income (i.e. profit and loss account and statement of total recognised gains and losses)
- Statement of Changes in Equity
- Statement of Cash Flows; and
- Notes

Other titles may still be adopted e.g. it is possible to use the term balance sheet rather than statement of financial position and profit and loss account instead of the income statement. That will occur in Ireland and the UK as those titles are contained in the Schedules to the Companies Acts.

However, there is one additional difference from full IFRS in that most private companies do not have unrealised gains and losses to go into the Statement of Comprehensive Income i.e., they have no unrealised revaluation gains and losses, no actuarial deficits and surpluses on defined benefit schemes, no exchange differences on translating foreign subsidiaries back into euros etc. In that case an SME can publish a combined Statement of Income and Retained Earnings instead of the separate Statement of Comprehensive Income and Statement of Changes in Equity. These documents are all covered in individual sections of the FRS and these are now discussed below.

Statement of Financial Position

(the balance sheet)

This section sets out the information to be presented in the statement of financial position. It specifies minimum line items and headings but really the only compulsory requirement is to keep current assets/liabilities away from non-current assets/liabilities. There are no headings for provisions so they must all be split appropriately into their current/non current headings. Although there is considerable flexibility in how it is presented within the IFRSSME that is the not case in FRS 102 which, for legal reasons, must retain the formats dictated by the Companies Acts. The Accounting Standards Board (now disbanded with the Financial Reporting Council taking on that role) published the following illustration to show compliance with both FRS 102 and EU legislation:

Balance Sheet
At 31 December 20X1

	Note	20X1 £'000	20X0 £'000
Non-current assets			
Investment property		345	345
Property, plant and equipment		3,466	3,751
Tangible assets		3,811	4,096
Intangible assets		1,245	1,412
Investments		360	360
		5,416	5,868
Deferred tax assets		100	90
Debtors due after more than one year		175	175
Total other non-current assets		275	265
Total non-current assets		5,691	6,133
Current assets			
Stocks		831	706
Debtors		1,202	1,318
Cash at bank and in hand		212	186
Total current assets		2,245	2,210
Creditors: amounts falling due within one year			
Trade creditors		1,296	1,800
Bank loans and overdrafts		18	
Current tax liability		100	120
Other finacial liabilities		212	255
Other creditors including tax and social security		340	375
Accruals and deferred income		198	180
Total current liabilities		1,824	2,355
Net current assets / (liabilities)		421	(145)
Total assets less current liabilities		6,112	5,988
Creditors: amounts falling due after more than one year		2,840	2,900
Deferred tax liability		112	97
Other provisions		353	313
Provisions for liabilities		465	410
Total non-current liabilities		3,296	3,315
Net assets		**2,807**	**2,678**
Capital and reserves			
Called up share capital		100	100
Share premium account		1,400	1,400
Profit and loss account		1,307	1,178
Equity attributable to owners of the company		**2,807**	**2,678**

Notes:

This closely resembles a current Irish balance sheet, but has extra headings and subtotals:

- to ensure compliance with the FRS;
- to demonstrate where sub-totals are required in order to continue to comply with company law.

In Particular:

- *The FRS defines current assets as those which the entity expects to realise or intends to sell or consume within the "normal operating cycle"; holds primarily for the purpose of trading; expects to realise within 12 months of the reporting date; or, holds as cash or a cash equivalent that is not restricted (full definition in FRS 4.5). The residual category of non-current assets therefore has a slightly wider scope than the Act's definition of fixed assets as those held for continuing use in the entity's business. This balance sheet shows a total for fixed assets, as required by company law under the Regulations, but then shows other non-current assets, thus complying with the FRS requirement to group non-current assets together (it does not explicitly require a subtotal).*
- *An additional total is also needed to comply with the FRS requirement to group non-current liabilities, made up of the [Regulations-required] headings of provisions and long term creditors.*
- *The FRS requires separate line items for current and deferred tax assets and liabilities.*

In this example, it has been assumed that Simple Limited does not have any derivative financial instruments to recognise on aplication of the FRS. Derivative financial instruments can be assets or liabilities, and current or non-current. Where an entity does have derivative finacial instruments they could be shown as part of a suitable category, eg 'other financial libilities', but additional line items may be required on the face of the balance sheet, particularly for derivatives that are assets.

Section 5

Statement of Comprehensive Income and Income Statement

(formerly the Statement of Total Recognised Gains and Losses and the Profit and Loss Account)

This section requires companies to choose between either one performance statement or two. Under EU law, however, entities will have to use the former title profit and loss account (and not the income statement) and adopt the two statement approach. Many, however, will be able to avoid this particular presentation if there are no unrealised gains and losses. Again there are no specified headings or line items and expenses in the IFRSSME but companies will have to follow the formats under EU law. They can still choose between the nature or functional presentation.

The two statement approach simply splits the Statement of Comprehensive Income into two separate documents with the profit and loss account (income statement) ending at net profit after tax and that total then constituting the first item in the Statement of Comprehensive Income. It fits well with the existing structure in FRS 3 i.e. the Profit and Loss account and the separate Statement of Total Recognised Gains and Losses. An illustrative example was published by the FRC as follows:

Simple Limited | 20x1

Profit and Loss Account[4]
for the year ended 31 December 20X1

	Note	20X1 £'000	20X0 £'000
Turnover		5,432	4,876
Cost of Sales		(3,695)	(3,511)
Gross profit		1,737	1,365
Administrative expenses		(562)	(538)
Other operating income		212	198
Operating profits[5]		1,387	1,025
Interest receivable and similar income		14	16
Interest payable and similar charges		(208)	(208)
Taxation		(394)	(258)
Profit on ordinary activities after taxation and for the financial year		**799**	**575**

Statement of Comprehensive Income[6]
for the year ended 31 December 20X1

	20x1 £'000	20x0 £'000
Profit for the financial year	799	575
Actuarial losses on defined benefit pension plans	(108)	(134)
Deferred tax movement relating to pension plans	28	34
Total Compreshensive Income for the year	**719**	**475**

[4] Profit and Loss Account is the title, required by Companies (Amendment) Act, 1986.
[5] This heading is not required by the Regulations or the FRS and could be omitted.
[6] Simple Ltd does not have the option under the FRS to present a single combined Statement of Income and Retained Earning in place of a statement of comprehensive income and a statement of changes in equity.
This is because it has changes in equity other than profit or loss, payment of dividends, corrections of prior period errors and changes in accouting policy (FRS 6.4).

Section 6

Statement of Changes in Equity and Statement of Income and Retained Earnings

The first document merely describes the changes in a company's equity every year. This will include the raising of new shares, the payment of dividends, total comprehensive income for the year, transfers across reserves, if any, and the correction of errors and the effect of changes in accounting policies. An example from the IFRSSME's Training Manual is illustrated here:

A group's consolidated statement of changes in equity for the year ended 31 December 20x7 (in thousands of currency units)

	Share Capital	Retained earnings	Hedges of foregin curreny risk in forecast transactions	Hedge of commodity price risk in forecast transactions	Attributable to owners of the parent	Non-controlling interests	Total equilty
Balance at 1 Jan 20x6	500,000	256,000	(4,000)	2,000	754,000	83,778	837,778
Correction of a prior period error	-	5,000	-	-	5,000	500	5,500
Changes in accounting policy	-	5,500	-	-	5,500	667	6,167
Restated balance at 1 Jan 20x6	500,000	266,500	(4,000)	2,000	764,500	84,945	849,445
Total comprehensive income	-	64,000	2,600	(1,100)	65,500	7,111	72,611
Profit or loss	-	60,000	-	-	60,000	6,000	66,000
Translation of foreign operations	-	6,400	-	-	6,400	2,110	8,510
Actuarial losses -- defined benefit plans	-	(2,400)	-	-	(2,400)	(999)	(3,399)
Changes in the fair value of the hedging instrument, net of tax	-	-	3000	(2,000)	1,000	-	1,000
Reclassified to profit or loss	-	-	(400)	900	500	-	500
Transactions with owners							
Dividends	-	(8,000)	-	-	(8,000)	(889)	(8,889)
Restated balance at 31 Dec 20x6	500,000	322,500	(1,400)	900	822,000	91,167	913,167

Many private companies will not have foreign currency hedges, they may but are unlikely to revalue their property and may not have defined benefit pension schemes. Thus the only movements that could be reported through this document might be changes in accounting policies, correction of errors, dividends paid and profits or losses. In that case the FRS permits a company to publish a simpler Statement of Income and Retained Earnings instead of the Statement of Comprehensive Income and the Statement of Changes in Equity. The IFRS for SMEs provides an illustration as follows:

XYZ Group

Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

(Alternative 2— illustrating the classification of expenses by nature)

	Notes	20X2 CU	20X1 CU
Revenue	5	6.863.545	5.808.653
Other income	6	88.850	25.000
Changes in inventories of finished goods and work in progress		3.310	(1.360)
Raw material and consumables used		(4,786.699)	(4,092,185)
Employee salaries and benefits		(936.142)	(879.900)
Depreciation and amortisation expense		(272.060)	(221.247)
Impairment of property, plant and equipment		(30.000)	-
Other expenses		(249.482)	(145,102)
Finance costs	7	(26.366)	(36.712)
Profit before tax	8	654.956	457,147
Income tax expense	9	(270.250)	(189.559)
Profit for the year		384,706	267.588
Retained earnings at start of year		2.171.353	2.003.765
Dividends		(150.000)	(100.000)
Retained earnings at end of year		**2.406.059**	**2.171.353**

In many ways this is quite similar to what private companies would have published in the past in what was called a profit and loss appropriation account.

Section 7

Statement of Cash Flows

This statement is quite different from the Cash Flow Statement in the local standard, FRS 1, in that there are only three headings instead of nine – operating, investing and financing. In effect it means that a number of cash flows will be recorded in different headings by different companies. For example interest payments, interest receipts and dividend receipts can be recorded in any one of the three headings. Even tax paid has no section although it is expected that most of it will be allocated to operating with only capital gains tax being likely to be recorded within the investing section.

The movement in cash flow is also different in that the reconciliation is to the increase/decrease in cash and cash equivalents rather than just cash, as in FRS 1. In practice that is unlikely to cause problems as cash equivalents are only short term investments that are highly liquid and held to meet short term commitments rather than for investment purposes.

There is no formal reconciliation of the movement in cash to the movement of net debt on the statement of financial position but they should both be tied up. There is also a free choice between adopting the direct method of reporting operating cash flows (i.e. cash from customers, cash paid to suppliers and employees etc) and the indirect method (reconciling profit before tax to operating cash flow by adjusting for working capital movements and non cash items in profit) but because it is expensive to adopt new systems for recording direct cash flows it is unlikely that Irish companies will switch from their current compulsory indirect approach under FRS 1. The format will follow that of the IFRSSME as it is not a legal requirement to publish a statement of cash flows.

The guidance notes to the FRS provides an example of the indirect method as follows:

Cash Flow Statement[i]
for the year ended 31 December 20X1

	Note	20X1 £'000
Cash flows from operating activities [ii]		
Profit for the financial year [iii]		6,099
Adjustments for:		
Depreciation of property, plant and equipment		899
Interest paid [iv]		12
Interest received		(3,011)
Taxation		2,922
Decrease/ (increase) in trade and other debtors		(72)
Decrease/ (increase) in stocks [v]		(194)
Increase/ (decrease) in trade creditors		234
Cash from operations [vi]		**6,889**
Interest paid		(12)
Income taxes paid		(2,922)
Net cash generated from operating activities		**3,955**
Cash flows from investing activities		
Proceeds from sale of equipment		42
Purchases of property, plant and equipment		(1,496)
Purchases of intangible assets		(71)
Interest received		3,011
Net cash from investing activities		**1,486**
Cash flows from financing activities		
Issue of ordinary share capital		206
Repayment of borrowings		(149)
Dividends paid		(2,417)
Net cash used in financing activities		**2,360**
Net increase/(descrease) in cash and cash equivalents		**3,081**
Cash and cash equivalents at beginning of year		(1,492)
Cash and cash equivalents at end of year [vii]		**1589**

Section 8

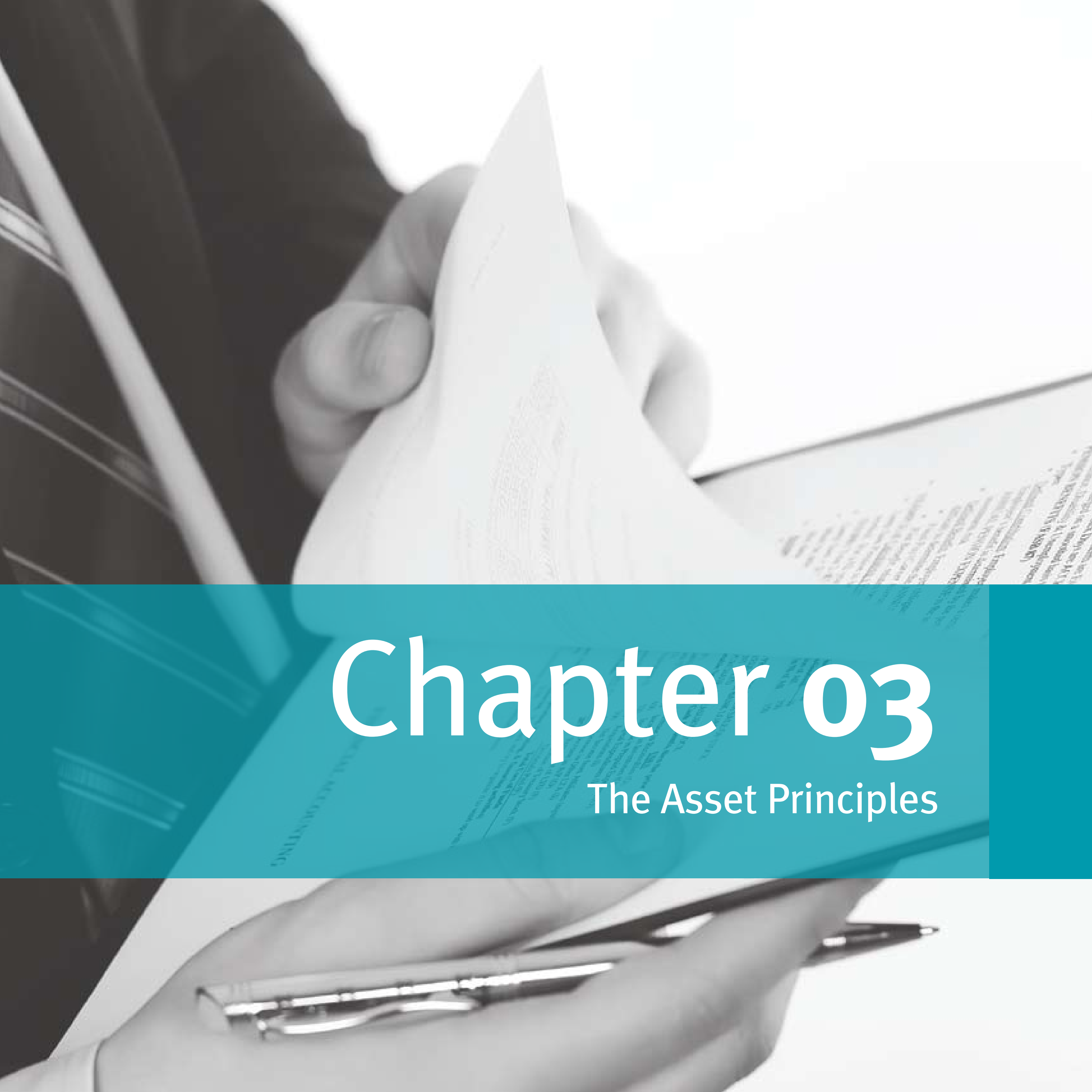
Notes

The final section dealing with the presentational aspects of financial reporting covers the notes that must be provided to back up the primary statements. Most of the content is determined by later sections of the FRS but there has been a determined effort to considerably reduce the amount of disclosure (by over 80%) from the full IFRSs. However, there will still be a requirement to include a section on the specific accounting policies adopted by the company and, for the first time, some discussion about the judgments required in applying the policies and the key sources of estimation uncertainty contained in those policies.

Summary

In terms of the presentation of financial statements most of the changes being introduced are fairly cosmetic in that they change the titles of the primary statements from the normal Irish GAAP headings. It must be remembered that the 'old' headings must still be adopted at present but over time they will almost certainly be dropped if the other EU countries decide to follow suit.

There are no substantial changes to the content of the statements apart from the introduction of a special *Statement of Income and Retained Earnings* which will probably be quite popular in Ireland for the average company. The biggest change is in the layout of the cash flow statement and the choice of two separate methods of presentation of operating cash flows. The indirect method is likely to remain the number one choice but decisions will have to be taken as to whether to include the method inside the statement or as a note. It is the author's personal opinion that it should be in the notes as there are a large number of non-cash items included which confuse the reader in their interpretation of the statement. Also there are few exemptions (apart from subsidiaries), unlike FRS 1, from publishing the document. It is regarded by the IASB as a major primary statement and thus must be published.



Chapter 03

The Asset Principles

Background

There are several sections of FRS 102 covering all types of assets from property, plant and equipment, to investment properties, intangible assets, leases and inventories. In this chapter I am excluding deferred tax assets and financial instrument assets as these will be covered in future chapters.

Section 17

Property, plant and equipment

The principles in this section of the FRS are very similar to both the full IAS 16 *Property, plant and equipment* and to the local standard FRS 15 *Tangible Fixed Assets*. Property, plant and equipment are defined as assets that:

- are held for use in the production or supply of goods and services, for rental or for administrative purposes; and
- are expected to be used during more than one period

They also include investment properties whose fair value cannot be measured without undue cost or effort.

Spare parts are usually carried as inventory but major spare parts are reported as property if they are expected to be used over more than one accounting period. Typical examples of property assets include:

- Factory buildings used to manufacture a company's products.
- Motor vehicles used by the sales staff in performance of their duties and vehicles provided for administration staff including the CEO and Directors.
- Administration buildings.
- Fixtures and fittings.
- Plant and machinery.

Recognition

The following recognition criteria must be applied in order to determine whether or not an asset can be reported:

- There must be a probability of future economic benefits flowing to the entity.
- Its cost can be reliably measured.

Major spare parts may require replacement at regular intervals and thus the cost of a replacement may be capitalised provided it is expected to provide incremental future benefits to the entity. There is more emphasis in the FRS on componentisation than in FRS 15 and therefore major components must be allocated part of the initial cost of the overall asset and be depreciated separately over their useful lives.

Land and buildings are treated as separable assets and should be accounted for separately even if they are acquired together.

Measurement at recognition

Property etc should be recognised initially at cost. The elements of cost that should be incorporated in the cost of an asset include:

- Its purchase price including any legal fees, import duties but after deducting any trade discounts.
- Any costs directly attributable to bringing the asset to the location and condition necessary of operating in the way intended by management e.g. site preparation, initial delivery and handling, installation and assembly and testing of functionality costs can be included.
- The initial estimate of the cost of dismantling and restoring the site.

However, the following are not permitted to be included as the costs of a property:

- The costs of opening a new facility.
- The costs of introducing a new product or service (including any advertising/promotion).
- The costs of conducting business in a new location.
- Administration and other general overheads.
- Notes.

In some industries it is a requirement to dismantle the old equipment by the government and this should also be capitalised, albeit discounted back to present value. It is particularly pertinent to mining and oil and gas extraction.

The standard also permits any borrowing costs to be included in the initial costs capitalised despite the fact that the full IFRS, IAS 23 *Borrowing Costs*, insists on compulsory capitalisation of borrowing costs in certain situations.

Measurement after initial recognition

All property, after initial recognition, must be recorded at cost less any accumulated depreciation and impairment losses or at revaluation (using fair value rather than existing use value). All property should be depreciated with the exception of land which usually has an unlimited life, except for assets such as quarries.

The depreciation charge should be recognised in arriving at profit and loss unless it has been included in the carrying amount of another asset e.g. equipment used to manufacture inventories. The depreciable amount should be allocated on a systematic basis over the asset's useful life and be based on the carrying amount i.e. either cost or revalued amount.

The residual values and useful lives of assets need not be reviewed every year but if there is any indication that either have changed then any changes should be treated as changes in the accounting estimate and reported in profit and loss. Under the full IFRSs an annual review is required but this was felt to be onerous for companies applying the standard and therefore, on cost/benefit grounds, it was dropped.

Depreciation begins when the asset is available for use and ceases from the date it is derecognised. It does not cease merely on retirement from active use unless it has been fully depreciated. Depreciation also can only cease when the machine is derecognised (i.e. sold) and not when a decision has been made to sell the asset. The section of IFRS 5 regarding the need to move non-current assets held for sale to current assets is NOT required by FRS 102. Also depreciation may not be suspended temporarily if the machine is idle, although under the unit of production method it is possible to have a depreciation charge of nil if no production occurs during the period.

The following factors must be considered in determining the useful life of an asset:

- the expected usage by reference to the asset's capacity or physical output
- any expected wear and tear
- technical or commercial obsolescence; and
- legal or similar limits e.g. leases

The depreciation method selected should reflect the pattern in which an entity expects to consume the asset's future economic benefits but straight line, reducing balance and units of production methods are the only ones specifically mentioned in the standard.

If a company has acquired a piece of equipment which is legally obsolete after a certain output and must be decommissioned then the most appropriate method would be to divide the total cost of the machine by the maximum output and depreciate on a unit of production basis. However, most companies should adopt straight line for the majority of their assets and perhaps only adopt reducing balance for vehicles where the costs of repairs rise over later years to be balanced by lower depreciation in those years.

Section 16

Investment Property

Similar to local Irish standards, investment properties are dealt with separately but the rules are different from the local SSAP. The definition is similar in that these properties are held for rental to third parties, for capital appreciation or for both purposes. It is possible that some properties might be mixed i.e. part is used by the entity for its own purposes and thus accounted for under Section 17 above and part under this section.

Under Section 16 investment properties are initially recorded at cost. Subsequently if a fair value can be measured without undue cost or effort then it must be fair valued with any gains and losses being reported within income. However, if a fair value cannot be measured reliably then it is accounted for as a normal item of property, plant and equipment, under Section 17 above.

This accounting treatment is different from the local standard SSAP 19 *Accounting for Investment Properties* in a number of respects. Under SSAP 19 a reporting entity:

i) must adopt a revaluation model and not charge depreciation; and

ii) must record all revaluation gains and losses in reserves and in the Statement of Comprehensive Income but not the Income Statement

Section 18

Intangible assets other than goodwill

This section applies to all intangible assets other than goodwill. Similar to the local standard, FRS 10 *Goodwill and Intangible Assets*, intangible assets are defined as identifiable non monetary assets without physical substance that are separable from the entity or else arise from legal or contractual rights.

Home-grown intangibles are not permitted to be recorded as assets on the Statement of Financial Position as the recognition criteria must be passed before they may be recognised as assets i.e.:

(a) It is probable that future economic benefits will flow to the entity.

(b) Their cost or value can be reliably measured.

(c) They do not result from internal expenditure.

Initially, if purchased, intangibles are recorded at cost and, if acquired as part of a business combination, at fair value. Subsequently intangibles must be amortised over their useful lives but that period should not exceed 5 years. This would normally be carried out on a straight line basis but both the amortisation periods and useful lives must be reviewed when there are indicators suggesting that either has changed since the previous reporting period.

One major difference between local accounting and FRS 102 is the treatment of development costs. These are covered locally separately in SSAP 13 *Accounting for research and development expenditure* and in that standard a reporting entity has a choice of capitalisation or immediate write off. This FRS makes it clear that that option is still retained. That approach differs from the IFRSSME, however, as all development costs are written off to profit on purely cost benefit grounds.

Section 13

Inventories

This section of the FRS covers the first part of SSAP 9 *Stocks and long term work in progress* and applies to most inventories including raw material, manufacturing work in progress, finished goods and goods held for resale. The principle is the same as SSAP 9 in that all inventory must be valued at the lower of their cost or estimated selling prices less costs to complete and sell.

Also similar to SSAP 9 the costs to incorporate within inventory include both the costs of purchasing raw material and ancillary costs such as customs duty, freight and transport costs to get the inventory to the company's premises. In addition, the cost to convert raw material into finished products based on the normal level of capacity and also essential to bringing the inventory to its present location and condition must be included in the valuation of inventory.

The methods that are permitted to charge inventory to production include both the First In First Out (FIFO) and the weighted average method but Last in First Out (LIFO) is specifically banned from use. Techniques such as process costing, standard costing and the retail gross profit margin method are all permitted as long as they bear a close relationship to the actual costs incurred in creating the inventory.

Inventories should be reviewed at the end of each reporting period for impairment and written down to their lower selling price less costs to complete and sell. However, unlike SSAP 9, that impairment may be reversed under certain circumstances but that is expected to be rare in practice.

Once the inventory is sold it should be expensed in the profit and loss account in the same period as the revenue to which it relates is recognised.

Section 20

Leases

Good news applies to the treatment of leases under the FRS as this section is very similar to SSAP 21 *Leasing and Hire Purchase Contracts* in that it artificially distinguishes finance leases from operating and requires the lessee to capitalise the former leases as assets on the Statement of Financial Position whilst at the same time recording the obligation due to the finance company (lessor) as a liability. Operating leases are treated as annual rental expenses in the profit and loss account of lessees.

The decision as to whether a lease is finance or operating can only be made at the inception of the lease. A finance lease can only be created if it transfers substantially all the risks and rewards incidental to ownership to the lessee. Examples include a legal transfer by the end of the contract, options to purchase the asset at a bargain price, a lease term that covers a substantial part of an asset's life and a leased asset that is specialised and really can only be used by the lessee.

If a finance lease is created then both the asset and liability are recognised at the lower of the present value of the minimum lease payments and the fair value of the asset. Each payment made by the lessee is then apportioned between the interest expense and the reduction in the liability and thus the interest charge must reflect the continual reduction in the principal owed. That means that a constant rate of interest on the outstanding liability must be charged each period – effectively ruling out the use of the straight line method and ensuring that either the sum of the digits or the actuarial method be adopted.

In addition, the finance lease asset must be depreciated over the shorter of the lease term (including both primary and secondary periods) and the useful life of the leased asset.

Although not covered in this booklet the Section also covers the accounting treatment required by lessors. It effectively mirrors the lessee by capitalising the asset and depreciating it in the normal way for operating leases and, in the case of finance leases, it recognises a receivable at an amount equal to the net investment in the lease with the finance income being recognised based on a pattern reflecting a constant rate of return on its net investment.

One major difference between SSAP 21 and the FRS is in the disclosure requirements. Under the FRS, for operating leases, entities must now disclose the total amount of non cancellable operating lease rentals due right to the end of the contract split between the amounts due within one year, between two and five years and over five years. In SSAP 21 only the annual commitments expiring within one year, between two and five years etc were required to be disclosed.

An example of the disclosure under the FRS is provided in the set of illustrative financial statements issued by the IASB as follows:

21. Commitments under operating leases

The Group rents several sales offices under operating leases. The leases are for an average period of three years. with fixed rentals over the same period.

	20X2 CU	20X1 CU
Minimum lease payments under operating leases recognised as an expense during the year	26,100	26,100

At year-end, the Group has outstanding commitments under non-cancellable operating leases that fall due as follows:

	20X2 CU	20X1 CU
Within one year	13,050	26,100
Later than one year but within five years	-	13,050
Later than five years	-	-
	13,050	39,150

Section 25

Borrowing costs

Unlike the IFRSSME the FRS permits companies to capitalise interest/borrowing costs within assets provided there is a long lead time between the construction of an asset and its ability to be used and for inventories where there is a long maturation period between initial production and final completion of the maturation process (i.e. end of production).

However, there are stringent rules regarding commencement, suspension and cessation of capitalisation for such assets as follows:

- **Commencement** - must not only borrow funds but there must also be physical activity taking place i.e. not only must the land be acquired but construction or process of maturation must also have commenced
- **Suspension** if there is a major suspension such as the foot and mouth crisis preventing construction to continue for 9 months, no capitalisation of borrowing costs can take place during that period. A temporary suspension, however, such as a sudden flood will not prevent capitalisation.
- **Cessation** no capitalisation is permitted once the asset is substantially ready for occupation or the inventory has matured.

The borrowing costs that may be capitalised can be the actual interest costs on specific borrowings but, more likely, it will be a mixture of funds and the company's weighted average cost of capital would be more appropriate.

Section 27

Impairment of Assets

This section applies to the impairment of nearly all assets other than those covered elsewhere in the FRS i.e. deferred tax assets, employee benefits, financial assets, investment property and biological assets

Inventories

Reporting entities must assess at each reporting date whether any inventories are impaired. The carrying amounts of each item of inventory should be compared with its selling price less costs to complete and sell. If an item is impaired a loss should be recognised (immediately in profit or loss) as the difference between the carrying amount and the selling price less costs to complete and sell. If it is impracticable to determine the selling price item by item entities can group items of similar product lines with similar purposes and marketed in the same geographical areas together for the purpose of assessing impairment.

A reversal of impairment is possible in some cases but only when the circumstances no longer exist for the impairment. That was not allowed in the local standard SSAP 9 *Stocks and long term work in progress* but is unlikely to be material in practice.

Impairment of assets other than inventories

Only if the recoverable amount is less than the carrying amount should the carrying amount of an asset be reduced to that recoverable amount. This is recognised immediately in profit or loss.

An entity must assess, at each reporting date, whether there is an indication of impairment. If it exists entities must estimate the recoverable amount of the asset. If there is no indication of impairment then it is not necessary to estimate that figure. However, if it is not possible to estimate impairment individually then entities must assess the recoverable amount at the level of a cash generating unit (CGU) – i.e. the smallest identifiable group of assets that generates cash flows largely independent of cash flows from other groups of assets.

In assessing whether an impairment exists the following minimum indicators must be considered:

External indicators

(a) an asset's market value has declined significantly over time or normal use

(b) significant changes with an adverse effect on the environment in which it operates or in the market to which the asset is dedicated have occurred.

(c) market interest rates have increased during the period and these are likely to materially affect the discount rate.

(d) the carrying amount of net assets is more than their market capitalisation.

Internal indicators

(e) there is evidence of obsolescence or physical damage.

(f) significant changes with an adverse effect on the entity or the manner in which the asset is used or expected to be used has occurred e.g. the asset is idle, there are plans to discontinue or restructure or dispose of the asset, and a reassessment of the useful life of the asset has occurred.

(g) there is evidence from internal reporting which indicates that economic performance was worse than expected.

If there is an indication of impairment then the useful life of the asset should also be reviewed as well as the depreciation method and its residual value adjusted even if no impairment loss has been recognised.

Measuring recoverable amount

The recoverable amount of an asset or a CGU is the higher of its fair value less costs to sell and its value in use.

It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount e.g. an asset held for disposal.

Fair value less costs to sell

Fair value less costs to sell is the amount receivable from the sale of assets in an arm's length transaction less costs of disposal. The best evidence of the fair value less costs to sell of an asset is a price in a binding sale agreement in an arm's length transaction or a market price in an active market. If there is no binding sale agreement or active market for an asset, the fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, entities must consider the outcome of recent transactions for similar assets within the same industry.

Value in use

Value in use is the present value of the future cash flows expected to be derived from an asset. This present value calculation involves the following steps:

- **(a)** estimating the future cash inflows/outflows from the continuing use of an asset and from its ultimate disposal, and
- **(b)** applying the appropriate discount rate.

The following should be included in an asset's value in use:

- **(a)** an estimate of the future cash flows the entity expects to derive from the asset.
- **(b)** expectations about possible variations in the amount or timing of future cash flows.
- **(c)** the time value of money, represented by the current market risk-free rate of interest.
- **(d)** the price for bearing the uncertainty inherent in the asset.
- **(e)** other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows expected from the asset.

In measuring the value in use, estimates of future cash flows must include:

- **(a)** projections of cash inflows from the continuing use of the asset.
- **(b)** projections of cash outflows that are necessarily incurred to generate the cash inflows from the continuing use of the asset and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset.
- **(c)** the net cash flows, if any, expected to be received (or paid) for the disposal of the asset in an arm's length transaction.

Recent financial budgets or forecasts to estimate the cash flows may be used and entities may wish to extrapolate the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years beyond the budgets/forecasts.

However, estimates of future cash flows must not include:

- **(a)** cash flows from financing activities, or
- **(b)** income tax receipts or payments.

Future cash flows should be estimated for the asset in its current condition and should not include any estimated future cash inflows or outflows that are expected to arise from:

- **(a)** a future restructuring to which an entity is not yet committed, or
- **(b)** by improving or enhancing the asset's performance.

The discount rate must be pre-tax reflecting current market assessments of:

- **(a)** the time value of money, and
- **(b)** the risks specific to the asset for which future cash flow estimates have not been adjusted.

The discount rate used should also not reflect risks for which the future cash flow estimates have been adjusted. That is to avoid double-counting.

Recognising and measuring an impairment loss for a cash generating unit (CGU)

An impairment loss must be recognised for a CGU if, and only if, the recoverable amount of the CGU is less than the carrying amount of the unit. It must be allocated to reduce the carrying amount of the assets of the CGU in the following order:

- **(a)** first, to reduce any goodwill allocated to the CGU, and
- **(b)** then, to the other assets of the CGU pro rata on the basis of the carrying amount of each asset in the CGU.

However, entities must not reduce the carrying amount of any individual asset in the CGU below the highest of:

- **(a)** its fair value less costs to sell (if determinable);
- **(b)** its value in use (if determinable); and
- **(c)** zero.

Any excess amount of the impairment loss that cannot be allocated above must be reallocated to the other assets of the CGU pro rata on the basis of the carrying amount of those other assets.

Additional requirements for impairment of goodwill

The fair value of goodwill cannot be measured directly thus it must be derived from measuring the fair value of a larger group of assets which includes the goodwill.

Goodwill acquired in a business combination must, at acquisition date, be allocated to each of the acquirer's CGUs that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Part of the recoverable amount of a CGU is attributable to the non-controlling interests (NCI) in goodwill. For the purpose of impairment testing a non-wholly-owned CGU with goodwill, the carrying amount of that unit is notionally adjusted, before being compared with its recoverable amount, by grossing up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the NCI. This notionally adjusted carrying amount is then compared with the recoverable amount of the CGU to determine whether or not the unit is impaired.

If goodwill cannot be allocated to individual CGUs (or groups of CGUs) on a non-arbitrary basis, then entities must test the impairment of goodwill by determining the recoverable amount of either (a) or (b):

- **(a)** the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated (i.e. the acquired business has been dissolved into the reporting entity).
- **(b)** the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.

Entities must separate goodwill into goodwill relating to entities that have been integrated and goodwill relating to entities not integrated. Also entities must follow the requirements for CGUs in this section when calculating the recoverable amount of, and allocating impairment losses and reversals to assets belonging to, the acquired entity or group of entities.

Reversal of an impairment loss

Goodwill impairment can never be reversed.

For all other assets entities should assess, at each reporting date, if there is an indication that an impairment loss no longer exists using the same indicators as for the original decision to impair.

Reversal when the prior impairment loss was based on the recoverable amount of an individual impaired asset:

- **(a)** Entities must estimate the recoverable amount of the asset at the current reporting date.
- **(b)** If the estimated recoverable amount of the asset exceeds its carrying amount, entities must increase the carrying amount to its recoverable amount, subject to the limitation in (c) below. That increase is a reversal of an impairment loss. The entity should recognise the reversal immediately in profit or loss unless carried at revalued amount in which case it is a revaluation increase.
- **(c)** The reversal of an impairment loss must not increase the carrying amount of the asset above the carrying amount that would have been determined had no impairment loss occurred in prior years.
- **(d)** After a reversal of an impairment loss is recognised, entities must adjust the depreciation charge to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversal when recoverable amount was estimated for a cash-generating unit:

When the original impairment loss was based on the recoverable amount of the CGU to which the asset belongs, the following requirements apply:

(a) Entities must estimate the recoverable amount of that CGU at the current reporting date.

(b) If the estimated recoverable amount of the CGU exceeds its carrying amount, that excess is a reversal of an impairment loss. Entities must allocate the amount of that reversal to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets, subject to the limitation in (c) below. Those increases in carrying amounts must be treated as reversals of impairment losses for individual assets and recognised immediately in profit or loss unless carried at revalued amount in which case it is a revaluation increase.

(c) In allocating a reversal of an impairment loss for a CGU, the reversal must not increase the carrying amount of any asset above the lower of

(i) its recoverable amount, and

(ii) the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised for the asset in prior periods.

(d) Any excess amount of the reversal of the impairment loss that cannot be allocated to an asset because of the restriction in (c) above must be allocated pro rata to other assets of the CGU.

(e) After a reversal of an impairment loss is recognised, if applicable, entities must then adjust depreciation for each asset in the CGU in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Disclosure

The following is considerably reduced from full IFRS and the only information that should be disclosed for each class of assets is as follows:

- the amount of impairment losses recognised in profit or loss and line items in the statement of comprehensive income.
- the amount of reversals of impairment losses in profit and loss and in line items in the statement of comprehensive income.

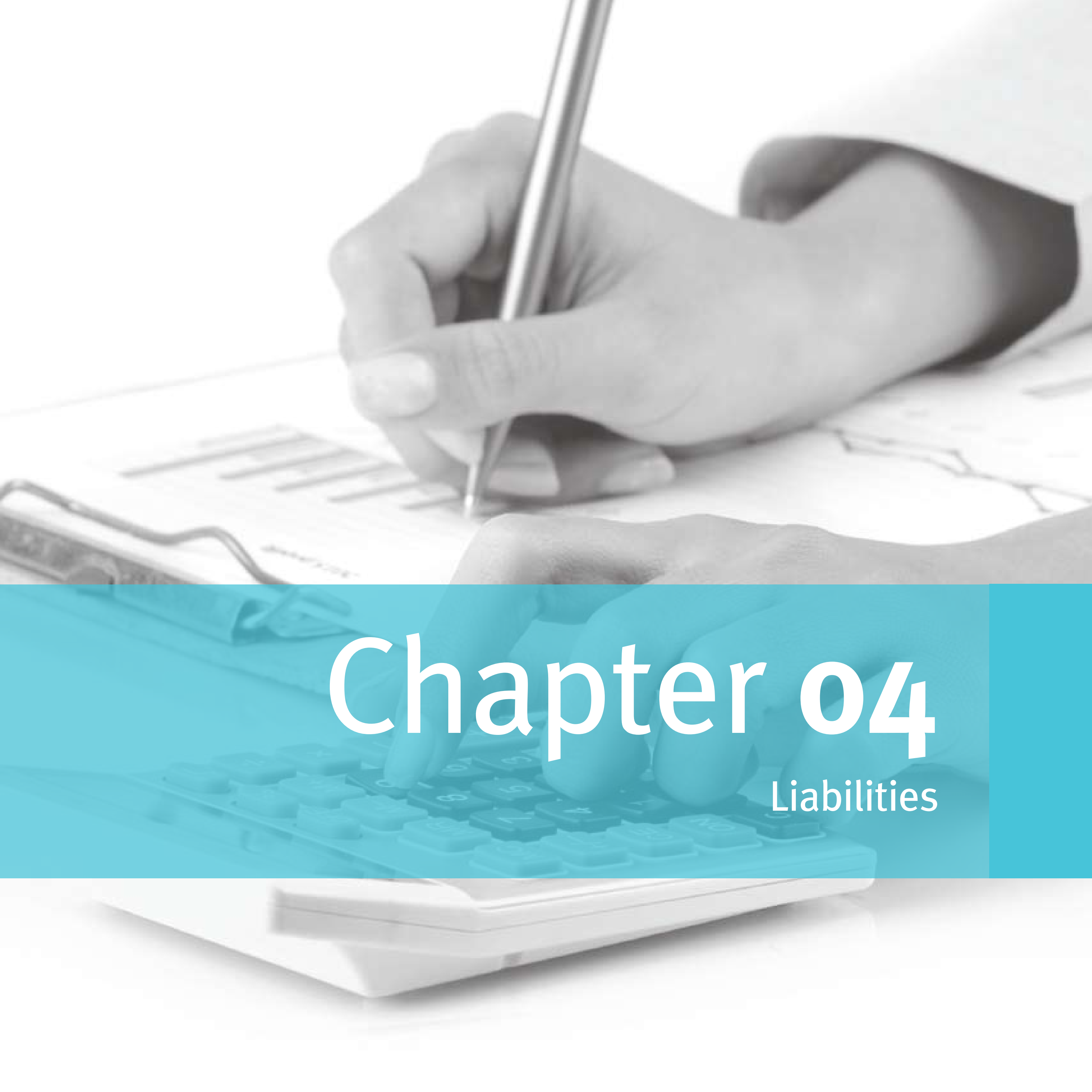
Entities must also breakdown the disclosure above for each of the following classes of asset: (a) inventories, (b) property, plant and equipment (including investment property by the cost method), (c) goodwill, (d) intangible assets other than goodwill, (e) investments in associates, (f) investments in joint ventures.

There is a need also to provide a description of the events and circumstances that led to recognition or reversal of an impairment loss.

Summary

When reviewing the asset standards it is clear that the local accounting standards are fairly similar to the new FRS 102. The main differences are the increased emphasis on componentisation of property, the maximum amortisation period of five years for intangible assets, the ability to capitalise borrowing costs for all assets with long maturation or construction periods and the increased disclosure required for operating leases. These sections of the FRS should therefore not pose too many difficulties in the switch over to the new FRS.

FRS 102 has also largely kept the same recognition and measurement principles as in the full IAS on impairment but there is very little disclosure required. As the IAS is similar to the local standard its implementation should not create particular problems on the transition from Irish GAAP.



Chapter 04

Liabilities

Section 21

Provisions and contingencies

There is very little difference in the accounting and disclosure requirements in FRS 102 compared to the local standard, FRS 12 *Provisions, contingent liabilities and contingent assets*.

A provision is defined as a liability of uncertain timing or amount. Section 21 does not apply to provisions that are covered by other sections of FRS 102. These include leases, construction contracts, employee benefit obligations, income taxes or insurance contracts which are covered in other more specific sections of the FRS under FRS 103.

Section 21 also does not apply to reductions in asset values e.g. provisions for accumulated depreciation, uncollectible receivables etc.

Initial recognition

A provision should only be recognised when:

(a) the entity has a present **obligation**; and

(b) it is **probable** that it will be required to transfer economic benefits; and

(c) its amount can be **reliably estimated**

The provision is a liability and an expense in profit or loss unless it forms part of the cost of creating another asset e.g. inventories, property etc.

A present obligation means an entity has no realistic alternative to settling the obligation. This can happen when it is enforced by law or when the entity has created a constructive obligation by creating a valid expectation that it will discharge the obligation. Obligations for future actions do not satisfy the condition no matter if contractual or how likely they are to occur e.g. a management intention to fit smoke filters on a factory would not be acceptable as the entity can still avoid that expenditure by closing down or changing their manufacturing processes.

Initial measurement

A provision should be measured at the **best estimate** of the amount required to settle the obligation at the reporting date:

(a) Where there is a large population of items, the estimate of the amounts can reflect the weighting of all possible outcomes by their associated probabilities.

(b) When an obligation arises from a single obligation the most likely outcome may be the best estimate.

When the time value of money is material the provision should be the present value of the amount expected to be required to settle the obligation. The discount rate should be pre-tax reflecting current market assessments of the time value of money. The specific risks to the liability should be reflected in the discount rate or the amounts required to settle the obligation.

When some of the provision may be reimbursed by another party, e.g. insurance, the entity should recognise a separate asset but only if it is virtually certain that the entity will receive the reimbursement. The asset must not be offset against the provision. However, there is a difference between FRS 102 and the IFRSSME in that the latter does permit offsetting in the statement of comprehensive income but this is NOT permitted in the local version.

Subsequent measurement

An entity should charge against their provisions only those expenditures for which they were originally recognised and each provision should be reviewed at each reporting date and adjusted to reflect its current best estimate. Any adjustments are charged in arriving at profit or loss. The unwinding of discount should be recognised as a finance cost.

Contingent liabilities

These are either possible but uncertain obligations or present obligations which fail one or both of the conditions for a provision. In these situations liabilities should not be recognised but disclosure is required, unless the chances of the contingencies occurring are remote.

Contingent assets

An entity should not recognise a contingent asset as an asset. Disclosure is only required in the notes where an inflow of benefits is probable. However, if it is virtually certain it should not be regarded as contingent – it should be recorded on the statement of financial position as a genuine asset.

Disclosures

For each class of provision an entity should disclose the following narrative and quantitative information:

- the carrying amount at the beginning and end of the period
- additional provisions made during the period including discounted adjustments
- amounts used during the period
- unused amounts reversed during the period
- a brief description of the nature of the obligation and the expected amount of any resulting payments
- an indication of the uncertainties about the amount or timing of outflows; and
- the amount of any expected reimbursement including any recognised as an asset

No comparative information is required due to the reconciliation of opening and closing balances of the current year.

Prejudicial disclosure

In extremely rare cases where disclosure can be expected to seriously prejudice the position of the entity in a dispute with other parties an entity need not disclose the information but should provide details of the general nature of the dispute together with the fact that and reason why the information has not been disclosed.

Provisions for pension liabilities and holiday entitlements are covered in Section 28 *Employee benefits* of the standard. These are covered in Chapter 5. Section 21, however, includes more specific guidance on recognising and measuring the following provisions but they broadly cover the same general principles:

- Future operating losses.
- Onerous contracts.
- Restructuring.
- Warranties.
- Refunds policies.
- Staff retraining.
- Court cases.

Section 29

Income Tax

The IFRSSME decided to go beyond current IFRS requirements and bring in the recognition and measurement rules proposed in an exposure draft published by the IASB in March 2009. This exposure draft was, however, subsequently abandoned. That has caused problems for the ASB and FRC in their attempt to publish an equivalent document which fits in with the IFRS endorsed by the European Union. The original approach taken was to remove the entire section 29 from their own version and replace it with the full IAS 12 *Income Taxes*. However, that approach did not go down well with commentators to the original proposals, FRED 44.

As a result FRS 102 has reintroduced the local standards FRS 16 *Current Tax* and FRS 19 *Deferred Tax* but, in addition, has added some additional requirements which will increase the amount of deferred tax reported on company books. That is an attempt to bring the UK/Irish version fairly close to the 'temporary difference' approach taken by the IASB. In effect it means that if a company revalues its property it must provide for the potential tax that would be paid if that property were ever to be sold and similarly in a fair value exercise during a business combination deferred tax must be provided on similar grounds.

Recognition and measurement of current tax

A **current tax liability** for tax payable on taxable profit for the current and past periods must be recognised. If the amount paid for the current and past periods exceeds the amount payable for those periods, the excess is a current tax asset.

A **current tax asset** is recognised for tax losses that can be carried back to recover tax paid in a previous period.

A current tax liability/asset is **measured** at the amounts it expects to pay (recover) using the tax rates and laws that have been enacted or substantively enacted by the reporting date.

Recognition of deferred tax

Deferred tax must be recognised in respect of all timing differences at the balance sheet date. Timing differences are differences between taxable profits and the income and expense as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Unrelieved tax losses and other deferred tax assets are only recognised to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

Reporting entities must recognise deferred tax on excess capital allowances. When all conditions for retaining the tax allowances have been met, the deferred tax is then reversed.

Deferred tax must also be recognised when income or expenses from a subsidiary, associate, branch, or interest in a joint venture have been recognised in the financial statements, and will be assessed to or allowed for tax in a future period, except where:

(a) the reporting entity is able to control the reversal of the timing difference; and

(b) it is probable that the timing difference will not reverse in the foreseeable future.

Where the amount attributed for tax purposes to assets (other than goodwill) and liabilities that are acquired in **a business combination** differs from their fair value, deferred tax must be recognised to reflect the future tax consequences with a corresponding adjustment to the amount attributed to goodwill.

However, permanent differences are not recognised.

Measurement of deferred tax

Companies must measure a deferred tax liability/asset using the tax rates and laws that have been enacted or substantively enacted by the reporting date that are expected to apply in the periods in which the timing difference is expected to reverse.

When different tax rates apply to different levels of taxable profit, an entity must measure deferred tax expense/income and related deferred tax liabilities/assets using the average enacted or substantively enacted rates that it expects to be applicable to the taxable profit (tax loss) of the periods in which it expects the deferred tax asset to be realised or the deferred tax liability to be settled.

In addition, companies must measure current and deferred taxes at the tax rate applicable to undistributed profits until the entity recognises a liability to pay a dividend. When the entity recognises a liability to pay a dividend, it should recognise the resulting current or deferred tax liability (asset), and the related tax expense (income).

Unlike the local standard FRS 19, deferred tax relating to a non-depreciable asset that is measured using the **revaluation model** in Section 17 must be measured using the tax rates and allowances that apply to the sale of the asset and similarly deferred tax relating to **investment property** that is measured at **fair value** must be measured using the tax rates and allowances that apply to the sale of the asset, except for depreciable investment property held within a business model whose objective is to consume substantially all of the economic benefits embodied in the property over time.

No discounting of deferred tax is permitted.

Withholding tax on dividends

FRS 102 has introduced additional paragraphs to deal with the unique UK/Irish problem of withholding taxes. When a company pays dividends to its shareholders, it may be required to pay withholding tax. The dividend reported should include any withholding tax (i.e. be gross) but it must exclude any other taxes, such as attributable tax credits.

Similarly, incoming dividends should include any withholding tax but exclude other taxes, such as attributable tax credits. Any withholding tax suffered is part of the tax charge.

Value Added Tax (VAT)

VAT is a European tax and thus not covered at all in the IFRSSME so the FRC have brought in the same rules as found in *SSAP 5 Accounting for value added tax*. As a result turnover shown should be disclosed net of VAT and expenses must be recorded exclusive of recoverable VAT.

However, irrecoverable VAT allocable to fixed assets and to other items must be included in their cost where practicable and material.

Presentation

Allocation in comprehensive income and equity

All changes in a current tax liability/asset and in a deferred tax liability/asset are treated as tax expenses.

The tax expense is recognised in the same component of OCI (i.e. continuing operations, discontinued operations, or other comprehensive income or equity) as the transaction or other event that resulted in the tax expense.

Presentation in the statement of financial position

Deferred tax liabilities are presented within provisions for liabilities and deferred tax assets within debtors.

Offsetting

This is only permitted if there is a legally enforceable right to set off the tax assets and liabilities and the company intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. An entity must only offset deferred tax assets and liabilities if, and only if:

- **(a)** there is a legal right of offset of current tax assets & liabilities
- **(b)** the deferred tax assets & liabilities are to the same tax authority.

Disclosures

The information to be disclosed should be sufficient to enable users to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events.

Companies must disclose separately the major components of the tax expense (income) and in OCI but there is also a requirement to disclose expected significant differences between the current tax charge and the standard rate of tax and of any changes in tax rates since the previous period as well as to provide back up to the deferred tax assets and liabilities.

Section 24

Grants

Recognition and measurement

Grants, including non-monetary grants must not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.

The IFRSSME decided not to apply the accruals concept enshrined in the full IAS 20 *Accounting for government grants and disclosure of government assistance* as it did not comply with the principles in the *Framework*. Instead the IASB opted for the performance model concerned more about getting the balance sheet right than with matching grant income with its related expenditure. Unfortunately that approach was not acceptable to commentators to the initial proposal in the UK and Ireland so the FRC has decided that grants may be recognised using either the performance or the accruals model.

Grants, however, are measured under both models at the fair value of the asset received or receivable and any grant repayable must be recognised as a liability when the repayment meets the definition of a liability.

Performance model

Grants are recognised as follows:

(a) a grant that does not impose specified future performance conditions is recognised in profit immediately when the grant proceeds are receivable.

(b) a grant that imposes specified future performance conditions is recognised in profit only when the performance conditions are met; and

(c) grants received before the revenue recognition criteria are satisfied are recognised as a liability.

Accrual model

Under this model, all grants must be classified either as revenue or capital. Revenue grants must be recognised in income on a systematic basis over the periods in which the entity recognises the related costs for which the grant is intended to compensate. Capital grants must be recognised in the income on a systematic basis over the expected useful life of the asset. Where part of a grant relating to an asset is deferred it shall be recognised as deferred income and not deducted from the carrying value of the asset. This is the model which Irish companies currently adopt in SSAP 4 *Accounting for Government Grants*

To illustrate the difference between the two models assume a capital grant of 100,000 has been received for an asset expected to have a useful life of 10 years but the government will only clawback grants over the first four years if the asset is not put to use. Assuming an even clawback over the four years the accruals model would release 10,000 to profit each year to match the depreciation charge over that period but the performance model would record 25,000 as income over the first four years only as the clawback recedes and the company performs under the agreement. The performance model does result in more volatility in the profit and loss account but it does record the liability owing to government correctly on the balance sheet.

Disclosure

The following should be disclosed:

- the accounting policy adopted
- the nature and amounts of government grants recognised in the financial statements
- unfulfilled conditions and other contingencies not recognised in income; and
- an indication of other forms of government assistance from which the entity has benefited (e.g. marketing or technical advice, low interest rates, government guarantees etc)

Section 22

Liabilities and Equity

This section of the FRS is similar to FRS 25 *Financial Instruments: Presentation*. It concentrates on the battle between what should be recorded as a liability and what should be equity. It uses the doctrine of substance over form in making that decision.

Redeemable preference shares are by nature more like debt as dividends must be paid to them and they have preferential rights to repayment which are redeemable thus there is no difference between those instruments and loans. Section 22 therefore records them as liabilities on the balance sheet with the dividends being recorded as a finance cost in arriving at profit before tax.

There are, of course, hybrid or compound instruments which are a mixture of both equity and debt and, in these cases, it is therefore a requirement to split the net proceeds received between both the debt and equity elements. The net element is always calculated first by applying a 'normal loan rate' to discount the future interest and principal repayments back to present value. Once that is calculated any difference between the present value and the net proceeds are recorded as equity. In addition each reporting period is charged with the normal rate of interest and this is added to the liability with any payment of interest being regarded as a reduction in the liability. Eventually the loan will rise back to its repayment value and this can either be repaid to the lenders or transferred to share capital and premium if converted into shares. The Appendix to Section 22 in FRS 102 provides an excellent example of how the process works.

Section 22 also covers the more legalistic issues of how to account for the original issue of shares, how to account for the sale of options or warrants, how to deal with capitalisation or bonus issues and it makes clear that any treasury shares acquired by a company be treated as a reduction from equity with no gain or loss reported in profit.

Finally Section 22 makes it abundantly clear that in a group scenario any shares not bought by the parent company must be recorded as non-controlling interests in the consolidated financial statements and reported within equity. Also any changes in those holdings not resulting in a change of control must be treated as transactions with equity holders with no gain or loss reported in profit. Any differences in carrying amounts are instead reported directly in equity.

Summary

The FRS has largely kept the same recognition and measurement principles as in the full IFRS on provisions but there is some useful additional guidance provided in the Appendix to Section 21 in deciding which provisions would pass the recognition criteria.

Section 29 poses a more significant problem for Irish companies in that, although the rules are similar, deferred tax will have to be calculated for revaluations and for fair value exercises in business combinations in accordance with the temporary methodology in the full IAS 12. However, it is pleasing to note that the full IAS 12 has been dropped from the final document which would have led to substantially increased disclosure. However, the broad principles in how to calculate deferred tax are similar between IAS 12 and the FRS.

Section 24 does provide companies with an interesting option in how their grants should be reported but I would imagine that most companies will stay with the accruals concept at present as they are used to that approach and it does result in better 'income smoothing'. Long term I think the IASB will remove that option from the main IAS and that will obviously have an impact on FRS 102 eventually.

Section 22 does not represent a change from current Irish reporting as reporting entities should already be adopting FRS 25 and applying the doctrine of substance over form in accounting for financial instruments.

Chapter 05

Performance Measurement

Accounting policies, estimates and errors

Selection and Application of Accounting policies

Management must use its judgement in applying accounting policies that result in information that is:

- **(a)** relevant to decision making; and
- **(b)** reliable in that the financial statements;
  - (i) represent faithfully the financial position, performance and cash flows of the entity
  - (ii) reflect economic substance
  - (iii) are neutral and fee from bias
  - (iv) are prudent; and
  - (v) complete in all material respects

This is really the practical application of the basic concepts and principles in Section 2 of the FRS. To achieve this management must consider the applicability of the following sources in descending order in making their judgement:

- **(a)** the requirements and guidance in the FRS dealing with similar issues
- **(b)** if within a SORP, the guidance in that SORP
- **(c)** the definitions, recognition criteria and measurement concepts in Section 2.

Management may also consider the guidance in full IFRSs dealing with similar issues but this is not required and slightly defeats the stand alone objective of the FRS. Most, if not all, transactions should be appropriately sorted out under a) to c) above.

The accounting policies must be consistent for similar transactions unless the FRS requires or permits categorisation of items with different policies might be more appropriate. A change in accounting policy is only permitted if a change:

- **(a)** is required by changes in the FRS; or
- **(b)** results in reliable and more relevant information

The following are examples of changes in accounting policies:

- **(a)** Reclassification of expenses from one type of expense to another e.g. treating haulage costs as cost of sales instead of distribution costs;
- **(b)** Moving an expense to becoming an asset e.g. decision to capitalise development costs instead of expensing them immediately; and
- **(c)** A change in measurement model e.g. from adopting FIFO to weighted average in inventory valuation but NOT a change in depreciation model from straight line to reducing balance as this is regarded as a change in useful life and therefore a change in accounting estimate.

When a change in policy is applied retrospectively (i.e. (b) and (c) above) the entity applies the new policy to comparative information as far back as practicable and should therefore adjust the opening balance for each affected component of equity. If that is **impracticable** the entity must apply the new policy to the earliest period for which retrospection is practicable. In the first case only the comparative year's financial statements need to be restated in line with the new policy so that the trend is maintained and entities are reporting like with like.

An entity should disclose:

- **(a)** The nature of the change in accounting policy
- **(b)** The reasons why the new policy provides reliable and more relevant information (if a voluntary change).
- **(c)** For the current period and each prior period, to the extent practicable, the amount of the adjustment for each financial statement line item affected; and
- **(d)** The amount of the adjustment relating to periods before those presented, to the extent practicable; and
- **(e)** An explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c).

Changes in estimates

Changes in estimates are adjustments to the carrying amount of assets/liabilities resulting from new information and are not corrections of errors. These should be recognised prospectively by including it in profit or loss in:

(a) the period of change if change affects that period only; or

(b) the period of change and future periods, if the change affects both.

There is a need to adjust the carrying amount of assets/liabilities in the period of change.

The nature and amount of a change in accounting estimate having an effect in the current period or future periods needs to be disclosed except if that is impracticable. If it is impracticable, that fact should be disclosed.

Corrections of prior period errors

These are omissions and misstatements for one or more prior periods. This includes all material mathematical mistakes, oversights and fraud. Unlike the local standard which defined errors as only those which are fundamental to providing a true and fair view this appears to open up more possibilities for prior period errors to occur. These should be corrected, in the first period discovered, retrospectively by:

(a) restating the comparatives for prior periods; and

(b) if the error occurred before the earliest period presented, restating the opening balances for the earliest period presented.

When it is impracticable to carry this out for one or more prior years an entity must restate the opening balances for the earliest period for which retrospective restatement is practicable. In addition the following should be disclosed:

(a) the nature of the prior period error;

(b) for each prior period presented, to the extent practicable, the amount of the correction for each line item affected;

(c) the amount of the correction at the start of the earliest prior period presented; and

(d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) and (c) above.

Section 23

Revenue

This section of the FRS should be applied in accounting for revenue from:

- sale of goods;
- rendering of services;
- construction contracts; and
- interest, royalties and dividends

Revenue should be measured at the fair value of consideration received or receivable but it must exclude any trade discounts and volume rebates agreed. Revenue should also exclude sales tax and VAT.

Where an inflow is deferred and the arrangement constitutes a financing transaction, the fair value of the consideration is the present value of all future receipts determined using an imputed rate of interest e.g. the provision of interest free credit to buyer. The imputed rate of interest is the more clearly determinable of either:

- the prevailing rate for a similar instrument of an issuer with similar credit rating; or
- a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the present value of all future receipts and the nominal value of the consideration should be recognised as interest revenue.

Usually revenue recognition criteria is applied separately to each transaction. However, the criteria should be applied to the separately identifiable components of a single transaction when necessary to reflect their substance e.g. when the selling price of a product includes an identifiable amount for subsequent servicing. Conversely two or more transactions are combined when an entity sells goods and agrees legally to repurchase those goods at a later date thus negating the substantive effect of the transaction.

For customer loyalty payments an entity should account for the award separately and allocate the fair value of the consideration receivable/received regarding the initial sale between the award credits and other components of the sale. The consideration allocated should be measured by reference to their fair value i.e. the amount that the awards could be sold for separately.

Sale of goods

Revenue can be recognised when all of the following conditions are satisfied:

- the entity has transferred to the buyer the significant risks and rewards of ownership;
- the entity retains neither continuing managerial involvement nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits will flow to the entity; and
- the costs incurred can be reliably measured.

The assessment of whether significant risks/rewards are transferred or not depends on the circumstances of the transaction. This mostly coincides with the legal title or the passing of possession but in other cases it could be at a different time.

Revenue should not be recognised if the entity retains significant risks. Examples of this are:

- when the entity retains an obligation for unsatisfactory performance not covered by normal warranties
- when the receipt from revenue is contingent on the buyer selling the goods
- when goods are shipped subject to installation and this is a significant part of the contract not yet completed
- when the buyer has the right to rescind the purchase (via contract) and the entity is uncertain about the probability of return.

If an entity retains only an insignificant risk of ownership the transaction is a sale e.g. when it retains legal title solely to protect collectability of the debt due or if it offers a refund if a customer is not satisfied. A provision for bad debts should separately be considered under Section 21.

Rendering of services

When the outcome of a service contract can be reliably estimated an entity should recognise revenue according to the stage of completion of a contract. It is only regarded as reliably measured if the following conditions are satisfied:

- the amount of revenue can be measured reliably;
- it is probable that the benefits will flow to the entity;
- the stage of completion can be measured reliably;
- the costs incurred and to complete can be measured reliably.

When services are performed by an indeterminate number of acts revenue should be recognised on a straight line basis over the specified period unless there is evidence that another method is better.

When the outcome cannot be estimated reliably revenue is only recognised to the extent of the expenses recognised that are recoverable.

Construction contracts

When the outcome of a construction contract can be estimated reliably, an entity must recognise contract revenue and contract costs as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period (the percentage of completion method). Reliable estimation of the outcome requires reliable estimates of the stage of completion, future costs and collectability of billings.

This section should be applied separately to each construction contract. However, in some circumstances, it is necessary to apply this section to the separately identifiable components of a single contract or to a group of contracts together in order to reflect its substance.

When a contract covers a number of assets, the construction of each asset must be treated as a separate construction contract when:

- **(a)** separate proposals have been submitted for each asset;
- **(b)** each asset has been subject to separate negotiation, and the contractor and customer are able to accept or reject that part of the contract relating to each asset; and
- **(c)** the costs and revenues of each asset can be identified.

A group of contracts must be treated as a single construction contract when:

- **(a)** the group of contracts is negotiated as a single package;
- **(b)** the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
- **(c)** the contracts are performed concurrently or in a continuous sequence.

Percentage of completion method

This method is used to recognise revenue from rendering services and from construction contracts. An entity shall review and, when necessary, revise the estimates of revenue and costs as the service transaction or construction contract progresses.

An entity must determine the stage of completion using the method that measures most reliably the work performed. Possible methods include:

- **(a)** the proportion that costs incurred for work performed to date bear to estimated total costs.
- **(b)** surveys of work performed.
- **(c)** completion of a physical proportion of the service transaction or contract work.

An entity must recognise costs that relate to future activity as an asset if it is probable that the costs will be recovered but it must expense immediately any costs whose recovery is not probable.

When the outcome of a construction contract cannot be estimated reliably:

- an entity must recognise revenue only to the extent of contract costs incurred that it is probable will be recoverable; and
- the entity must recognise contract costs as an expense in the period incurred.

When it is probable that total contract costs will exceed total contract revenue on a construction contract, the expected loss must be recognised as an expense immediately, with a corresponding provision created for an onerous contract (see Section 21).

If the collectability of contract revenue is no longer probable, the entity must recognise the uncollectible amount as an expense rather than as an adjustment of contract revenue i.e. as a bad debt.

Interest, royalties and dividends

Revenue is recognised when:

- it is probable that the economic benefits associated with the transaction will flow to the entity; and
- the amount can be measured reliably.

Revenue should be recognised on the following bases:

- interest using the effective interest method
- royalties on an accruals basis
- dividends when the shareholder's right to receive payment is established (normally when paid or at least agreed by the members in general meeting)

The disclosures required include:

- the accounting policies adopted for recognising revenue including the methods adopted to determine the stage of completion
- the amount of each category of revenue recognised during the period
- specific disclosures for construction contracts including revenue recognised, methods adopted to determine revenue and to determine the stage of completion as well as the gross amount due from customers for contract work as an asset, and the gross amount due to customers as a liability

The FRS also has a fairly lengthy appendix to illustrate how the general principles can be applied to 26 specific examples and these should provide useful guidance for preparers.

Section 28

Employee Benefits

All forms of consideration provided by an entity to its employees in exchange for services rendered are captured in this section of the FRS. There are four broad types:

(a) short term employee benefits due within 12 months

(b) post-employment benefits

(c) other long term employee benefits not due within 12 months; and

(d) termination benefits due to early retirement or voluntary redundancy.

The general principle is that the cost of all employee benefits should be recognised:

(a) as a liability after deducting amounts already paid directly to employees; and

(b) as an expense unless the cost can be included within inventories or in the cost of property.

(a) Short-term employee benefits

This includes wages, salaries and social security contributions; profit sharing and bonuses payable within 12 months and non-monetary benefits e.g. medical care, housing, cars, free or subsidised goods etc.

These should be measured at the undiscounted amount of short-term employee benefits expected to be paid in exchange for an employee's service.

It is only those short-term absences that accumulate e.g. annual holiday pay that can be carried forward. The expected cost of accumulating compensated absences should be recognised when the employees render service and measured at the additional amount the entity expects to pay as a result of the unused entitlement accumulated at the end of the reporting period. These are presented as current liabilities.

However, the cost of other non- accumulating absences should be charged when the absences occur at an undiscounted amount.

Profit sharing schemes are also included but must NOT be recognised unless

(a) there is a legal or constructive obligation; and

(b) a reliable estimate of the obligation can be made

(b) Post- employment benefits

These include retirement benefits such as pensions and other post-employment benefits such as medical care.

They are all classified as either defined contribution or defined benefit plans depending on their principal terms and conditions.

(i) **Defined contribution plans** (DC) – fixed contributions are paid into a separate fund but the entity has no further obligation to pay further contributions. The benefits paid to pensioners depend on the contributions paid in and the investment returns thereon.

(ii) **Defined benefit plans** (DB) – these are classified as other than DC plans. There is an obligation of the entity to provide the agreed benefits based on both actuarial and investment risks. If these are worse than expected then there is a need to make good that deficit and reflect that as an obligation of the reporting entity.

Post-employment benefits: defined contribution (DC) plans

The contributions payable for a period should be recognised:

(a) as a liability after deducting any amounts already paid. If contributions exceed contributions due, the excess is recorded as an asset

(b) as an expense unless capitalised within inventories or property.

Post-employment benefits: defined benefit (DB) plans

A liability should be recognised as the net total of the following amounts:

(a) the present value of an entity's obligations at the reporting date, minus

(b) the fair value of its plan assets at the reporting date.

To arrive at present value a discount rate should be chosen which refers to market yields at the reporting date on high quality corporate bonds and the actuarial valuation method adopted should be the projected unit credit method to determine an entity's DB obligations and related current and past service costs.

The FRS does not require an entity to engage an independent actuary to perform the comprehensive actuarial valuation needed to calculate its DB obligation nor does it require a comprehensive actuarial valuation to be carried out annually. In the periods between comprehensive actuarial valuations, if the principal actuarial assumptions have not changed significantly the defined benefit obligation can be measured by adjusting the prior period measurement for changes in employee demographics such as number of employees and salary levels.

The cost of a defined benefit plan is represented by the NET CHANGE in the DB liability and is recognised in profit or loss unless it is capitalised in inventories or property.

FRS 102 requires actuarial gains and losses in the period to be recognised in the period they occur and reported in other comprehensive income and included in the statement of comprehensive income.

The NET CHANGE includes:

- **(a)** the change in the DB liability arising from employee service rendered during the period
- **(b)** net interest on the DB obligation during the period
- **(c)** actuarial gains and losses during the period
- **(d)** increases/decreases in the DB liability as a result of a new plan or change in an existing plan
- **(e)** decreases in the DB liability from curtailment or settlement of an existing plan during the period.

In accounting for multi-employer DB pension plans, many companies adopt the DC approach as they are unable to identify the specific deficit/surplus that belongs to their company. The information is generally not available. That is still acceptable but, where a deficit exists in the plan and the participating employers have agreed a schedule of payments to fund that deficit, entities must now recognise a liability to make payments to fund that deficit relating to past service where they have entered into an agreement to make those payments.

(b) Other long-term employee benefits

These include long-term compensated absences such as sabbatical or long service leave; long service benefits; long term disability benefits; profit sharing and bonuses payable 12 months or more after period end; and deferred compensation paid 12 months or more after the period end. They are relatively rare in Ireland.

A liability should be measured at the net total of the following amounts:

- **(a)** the present value of the benefit obligation at the reporting date, minus
- **(b)** the fair value of plan assets at the reporting date

Any change in the liability should be in profit or loss or capitalised as inventories, plant etc.

(c) Termination benefits

An entity may be committed to make payments when an employee's service is terminated.

Because there are no future economic benefits to the entity these should be expensed immediately in profit or loss.

The termination benefits should be recorded as a liability and an expense only when the entity is demonstrably committed either:

- to terminate the employment of an employee or group before normal retirement age; or
- to provide termination benefits to encourage voluntary redundancy.

There needs to be a detailed formal plan with little realistic possibility of withdrawal from the plan.

The liability should be measured at the best estimate of expenditure required to settle the obligation at the reporting date and based on the number of employees expected to accept the offer and if they are going to be paid more than 12 months after the end of the accounting period they should be discounted to present value.

Disclosure

There are no specific disclosures required for short term employee benefits and for DC schemes the total recognised in profit or loss as an expense must be disclosed but considerable disclosures about defined benefit plans are required due to their open ended liability nature. These include:

- **(a)** a general description of the type of plan, including funding policy
- **(b)** the date of the most recent comprehensive actuarial valuation, and if not at year end, what adjustments were made to measure the DB obligation at the reporting date
- **(c)** a reconciliation of opening and closing balances of the DB liability showing separately any benefits paid and all other changes
- **(d)** a reconciliation of the opening and closing balances of fair value assets
- **(e)** the total cost for the period
- **(f)** the key assumptions including the discount rates adopted; the expected rates of salary increases; medical cost trend rates; and any other material actuarial assumptions used.

There is some limited disclosure required for long term benefits and termination benefits.

Section 26

Share based Payment

The FRS applies to all share based payment transactions including:

- **(a)** equity settled transactions
- **(b)** cash settled transactions; and
- **(c)** transactions where the entity receives or acquires goods or services and the terms provide either the entity or the supplier with a choice of cash or equity settlement.

Generally most of the schemes in Ireland are equity settled i.e. holders have the option of receiving shares in the reporting entity rather than receiving a cash payment. They can be awarded to suppliers or, more likely, to employees.

Recognition

Entities should recognise goods or services received when they obtain the goods or as services are received. There should also be a corresponding increase in equity, if equity based, or a liability, if cash settled.

Recognition when there are vesting conditions

If the share-based payments granted to employees **vest** immediately, the employee is not required to complete a specified period of service before he/she is entitled to those share-based payments. The entity should therefore presume that services rendered by the employee as consideration for the share-based payments have been received. In this case therefore, on grant date, the entity must recognise the services received in full with a corresponding increase in equity or liabilities.

If the share-based payments do not vest until the employee completes a specified period of service, the entity must presume that the services to be rendered as consideration will be received in the future, during the vesting period.

An entity must therefore account for those services as they are rendered by the employee during the vesting period, with a corresponding increase in equity or liabilities. This would be the more normal situation where an employee has to work three years for the companies before the options vest and loses all rights if he/she leaves the company during any of those three years.

(a) Measurement of equity settled share based payment transactions

The goods or services received, and the corresponding increase in equity, should be measured at the fair value of the goods or services received, unless that fair value cannot be estimated reliably.

If the entity cannot estimate reliably the fair value of the goods or services received, then it must measure their value, and the corresponding increase in equity, by reference to the fair value of the equity granted. To apply this requirement to transactions with employees and others providing similar services, the entity must measure the fair value of the services received by reference to the fair value of the equity granted, because it is not possible to estimate reliably the fair value of the services received.

For transactions with employees, the fair value of the equity must be measured at grant date.

A grant of equity might be conditional on employees satisfying specified vesting conditions related to service or performance. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit (a non-market vesting condition) or a specified increase in the entity's share price (a market vesting condition). All vesting conditions related to solely employee service or to a non-market performance condition must be taken into account when estimating the number of equity shares that are expected to vest. Subsequently, the entity should revise that estimate, if necessary, if new information indicates that the number of equity shares expected to vest differs from previous estimates. On vesting date, the estimate must be revised to equal the number of equity instruments that ultimately vested.

All market vesting conditions and non-vesting conditions must be taken into account when estimating the fair value of the shares or share options at the measurement date, with no subsequent adjustment irrespective of the outcome.

Shares

The fair value of the shares must be measured using the following three-tier measurement hierarchy:

- **(a)** if an observable market price is available for the equity granted, use that price
- **(b)** if an observable market price is not available, measure the fair value of equity granted using entity-specific observable market data such as (i) a recent transaction in the entity's shares, or (ii) a recent independent fair valuation of the entity or its principal assets.
- **(c)** If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of the shares or SARs using a valuation method that uses market data to the greatest extent practicable to estimate what the price of those equity shares would be on the grant date in an arm's length transaction between knowledgeable, willing parties. The entity's directors should use their judgement to apply the most appropriate valuation method to determine fair value.

(b) Cash settled share based payment transactions

The goods and services acquired should be measured and liability at the fair value of the liability. Until that is settled the fair value must be remeasured at each reporting date and date of settlement with any changes in fair value being reported as profit or loss.

For employee transactions, if the equity does not vest until completion of a period of service, the entity should recognise the services received as the employees render service during that period.

(c) Share based payment transactions with cash alternatives

An entity should account for a transaction as cash settled if and to the extent it has incurred a liability to settle in cash or as equity settled if and to the extent that no such liability has been incurred. It is treated as cash settled unless either:

(a) the entity has a past practice of settling by issuing equity, or

(b) the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than the fair value of the equity, in which case it is treated as equity settled.

Disclosure

The following must be disclosed re the nature and extent of share based payment arrangements:

(a) a description of each type of share based payment that existed at any time during the period should be disclosed, including their general terms and conditions e.g. vesting requirements, maximum term of options granted, method of settlement etc. May aggregate similar types of arrangements

(b) the number and weighted average exercise prices of share options for each of the group of options including reconciliations of outstanding options for the period.

For equity-settled arrangements, entities must disclose information about how it measured the fair value of goods or services received or the value of the equity instruments granted. If a valuation methodology was adopted, it must also disclose the method and its reason for choosing it.

For cash-settled arrangements, information must be disclosed about how the liability was measured.

In addition, the following must be disclosed about the impact of share-based transactions on an entity's profit or loss for the period and on its financial position:

(a) the total expense recognised in profit or loss for the period; and

(b) the total carrying amount at the end of the period for liabilities arising from share-based transactions.

Summary

FRS 102 has decided to include the same basic recognition and measurement rules as contained in the full international financial reporting standards. It is surprising that it has decided to include the complicated defined benefit recognition rules as well as those for share option schemes. In addition, there is considerable disclosure still required for those companies with DB schemes.

There is no local accounting standard on revenue recognition but the principles are fairly well covered in FRS 5 *Reporting the Substance of Transactions* and there are therefore unlikely to be any major changes in the reporting of revenue. Section 10 on accounting policies, estimates and errors is virtually the same as FRS 18 *Accounting Policies* so no real changes are expected from its implementation apart from the broader definition of errors in FRS 102 from the local FRS 3 *Reporting Financial Performance* which could result in more errors being adjusted through reserves rather than as expenses/incomes in the profit and loss account.

Chapter 06

Foreign Currency

Section 30

Foreign Currency Translation

In this chapter I want to look at the accounting and disclosure required when a reporting entity gets involved with foreign activities. These can be conducted in two different ways – by selling or buying goods and services abroad (i.e. **transaction accounting**) and/or by translating foreign operations back into the functional currency of the parent company for consolidation purposes (i.e. **translation accounting**). However, unlike the local accounting standard SSAP 20 *Foreign Currency Translation* Section 30 of FRS 102 does not cover hedge accounting as that is regarded as part of the financial instruments project and is covered in a separate section of the standard.

Definitions do not play a key role in most sections of the standard but, in Section 30, the definition of functional currency is very important as a reporting entity must keep its books and records in that currency at all times.

Functional currency

This is defined as the currency of the primary economic environment in which an entity operates. Normally it is the currency of the country where the entity primarily generates and expends cash. Therefore, the most important factors to consider when determining functional currency are:

(a) the currency that mainly influences the entity's sales prices and the country whose competitive forces and regulations mainly determine those prices.

(b) the currency that mainly influences labour, material and other costs of providing goods and services.

In addition however, particularly where it may not be obvious to identify the functional currency, the following factors should also help to provide evidence of the functional currency of an entity:

(a) the currency in which funds from financing are generated; and

(b) the currency in which receipts from operating activities are normally retained.

When investigating a foreign operation such as a branch, associate or subsidiary the following factors must also be considered:

(a) whether the activities of the foreign operation are an extension of the reporting entity rather being carried out with a degree of autonomy e.g. the former only sells goods of the 'parent' entity and remits proceeds directly to and solely to that entity.

(b) whether the transactions with the entity are a high or a low proportion of the foreign entity's activities

(c) whether the cash flows of a foreign operation directly affect the cash flows of the reporting entity; and

(d) whether the cash flows of a foreign operation are sufficient to service existing and expected debt without the funds being made available by the entity.

For most Irish private companies it will be obvious that the euro will be the functional currency of the company but there are a number of subsidiaries of multi nationals who have had to record their transactions in a foreign currency (e.g. Bombardier Shorts Ltd in Belfast and Elan Pharmaceuticals Plc in Athlone) as their dominant currency is the dollar. In some cases it will involve considerable judgement in deciding on what an entity's functional currency is. Under SSAP 20 there was no functional definition but records had to be kept in the company's local currency.

Reporting foreign currency transactions in the functional currency

Initial recognition

Assuming the reporting entity is based in Ireland and after having investigated their functional currency it has been decided that the Euro is its functional currency then how should transactions for goods and services outside the Euro Zone be recorded in the entity's own financial statements? This is known as the foreign currency transaction problem.

A foreign currency transaction therefore occurs :

(a) where a company buys or sells goods or services whose prices are denominated in a foreign currency (i.e. in this case not Euro);

(b) where an entity borrows or lends funds when the amounts payable/receivable are denominated in a foreign currency; or

(c) otherwise where the entity acquires or disposes of assets or incurs liabilities denominated in a foreign currency.

Initially the reporting entity should apply the spot exchange rate on the date of the transaction but the standard does permit an approximate rate for a large number of similar transactions e.g. the average rate for a week is often used as long as the exchange rates do not fluctuate significantly over that period.

Reporting at the end of the subsequent reporting period

At the end of each reporting period an entity should:

(a) translate all foreign currency **monetary items** at the **closing rate** of exchange;

(b) translate all **non monetary items** at the exchange **rate at the date of transaction**; and

(c) translate all **non monetary items** measured at **fair value** using exchange rates when the **fair value is determined**.

Exchange differences on monetary items should always be recognised in profit or loss in the period they arise – at both settlement and at period end dates.

Example

A company purchased goods from USA on 31st December for $120,000, half due on 28th February and the rest on 30th April.

The following exchange rates ruled:

	$ = €1
31st December	1.60
28th February	1.80
31st March	1.90
30th April	1.85

1. On 31st December - date of transaction

DR	Purchases	€75000	
CR	Trade Payables		€75000

ie, €120,000 @ $1.60/€1

2. On 28th February - half paid @ $1.80/€1

DR	Trade Payables	€37500	
CR	Cash		€33,333
	Exchange Gain		€4167

ie, $60000 @ $1.80/€1 = €33333

3. At 31st March - year end liability @ $1.90/€1

DR	Trade Payables	€5922	
CR	Exchange Gain		€5922

ie, $60000 @ $1.90/€1 = €31578 - €37500

4. 30th April - pay $60000 @ $1.85/€1

DR	Trade Payables	€31578	
	Exchange Loss	€5922	
CR	Cash		€32433

The accounting entries are no different from the current SSAP 20 approach.

The Translation problem - Net investment in a foreign operation

An entity may have a monetary item receivable or payable from a foreign operation. If the settlement is neither planned nor likely to occur soon it is, in substance, part of the entity's net investment in the foreign operation. This could include long term receivables or loans.

Exchange differences on a monetary item that forms part of an entity's net investment in a foreign operation should be recognised in profit or loss in the entity's statements or foreign operations as appropriate. In the consolidated accounts, exchange differences should be recognised directly as a separate component of equity and also recorded as part of comprehensive income. However, unlike the full IFRSs they are not subsequently recycled through profit and loss on disposal.

Change in functional currency

It is highly unlikely that a change in functional currency will occur as it really means a substantial shift in the business activities from being dominated by one currency to another. However, If there is a change in the functional currency of a reporting entity then the entity should apply translation procedures prospectively to the new currency from the date of change.

A change is only permitted if there is a change to the underlying transactions. The effect of a change in functional currency is accounted for prospectively i.e. use the exchange rate at the date of change. The resulting translated amounts are then treated as the new historic cost.

The adoption of a presentation currency other than the functional currency

It is unlikely that many private companies in Ireland would want to publish their financial statements in a different currency from their functional. However, if the shareholders are from a different country they may wish the financial statements to be presented in a currency they understand. It is purely optional for a company to adopt a different presentation currency from their functional currency. The option of a different presentation currency was not offered in SSAP 20.

Translation to the presentation currency

Normally entities must adopt the following procedures:

- **(a)** assets and liabilities are translated at closing rate
- **(b)** income and expenses are translated at the rates of exchange at the dates of the transactions
- **(c)** all exchange differences are recognised within other comprehensive income

For practical reasons entities may adopt a rate that approximates actual rates, e.g. average rates, but not if the rates fluctuate significantly.

The exchange differences result from:

- **(a)** translating income and expenses at transaction dates, not closing rate
- **(b)** translating opening net assets at closing rate which differs from the previous closing rate

When exchange differences relate to an operation with non-controlling interests then part of those differences must be allocated to them.

However, any entity whose functional currency is the currency of a hyperinflationary economy must translate its results and financial position into a different presentation currency using the procedures specified in Section 31 *Hyperinflation* of the standard (see below).

The Translation problem - Translation of a foreign operation into the investor's presentation currency

Reporting entities should follow normal consolidation procedures e.g. the elimination of intragroup balances and transactions. The closing rate method is adopted for the statement of financial position but, unlike the choice in SSAP 20, the income statement must adopt the rates when the transactions have taken place or adopt average rates. The closing rate is not permitted.

Unlike SSAP 20, there is no concept of the 'temporal method' of translation. In SSAP 20 this method of translation was adopted where a foreign entity's trade was more dependent on the economic environment of the investment company's currency than that of its own. Under FRS 102 each entity has instead to determine its own functional currency. A foreign entity whose trade is dependent on the economic environment of the investing company's currency will therefore have the same functional currency as the investing company and therefore no need for translation.

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the **carrying amounts** of assets and liabilities arising on the acquisition of that foreign operation must be treated as assets and liabilities of the foreign operation. Thus, they must be expressed in the functional currency of the foreign operation and be translated at the closing rate.

Disclosures

The FRS does not require extensive disclosure. All a reporting entity must disclose is the following:

- **(a)** the amount of exchange differences recognised in profit or loss except for financial instruments measured at fair value through profit or loss
- **(b)** the exchange differences classified as equity in the period

The presentation currency must be disclosed and, if different from the functional, that fact and the reason for the adoption of a different presentation currency. Where there is a change in functional currency that fact and the reason for that change must also be disclosed.

Section 31

Hyperinflation

Although unlikely to arise for the vast majority of companies in Ireland the FRS does contain an additional section which applies to an entity whose functional currency is the currency of a hyperinflationary economy. It requires such an entity to prepare financial statements that have been adjusted for the effects of hyperinflation prior to translation and consolidation.

When is an economy deemed to be hyperinflationary? That is a judgment call by considering all the available information including, but not limited to, the following possible indicators of hyperinflation:

- **(a)** The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power.
- **(b)** The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency e.g. the dollar. Prices may be quoted in that currency.
- **(c)** Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short.
- **(d)** Interest rates, wages and prices are linked to a price index.
- **(e)** The cumulative inflation rate over three years is approaching, or exceeds, 100 %.

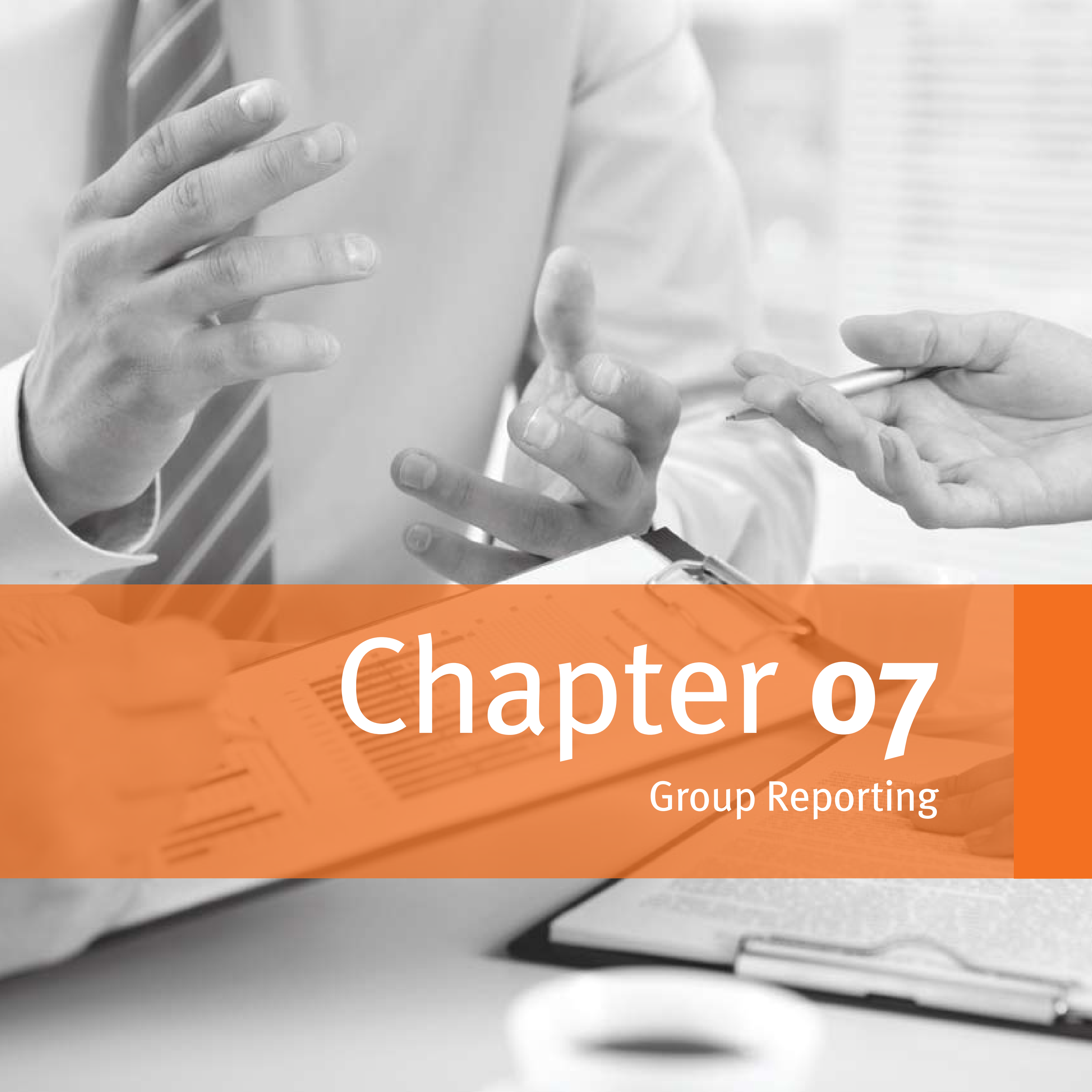
If the reporting entity has such an investment then all amounts in the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy must be restated in terms of the measuring unit current at the end of the reporting period. The comparative information for the previous period must also be stated in terms of the measuring unit current at the reporting date.

This is really a form of current purchasing power accounting as the restatement requires the use of a general price index that reflects changes in the economy's general purchasing power.

The section goes on to prescribe the procedures to be undertaken to restate the historic financial statements in those situations and how to deal with situations when the economy is no longer hyperinflationary. There are some specific disclosures required particularly regarding the index adopted, the amount of any gains/losses on holding monetary items and the fact that the financial statements have been restated

Summary

Overall nobody in Ireland should have any fears in implementing Sections 30 and 31. The principles in Section 30 are virtually identical to SSAP20, there is little disclosure required and it is unlikely that many companies will be forced to avail of Section 31. FRS 102 is also no different from the IFRSSME.



Chapter 07

Group Reporting

Section 9

Consolidated and Separate Financial Statements

Under FRS 102, an entity is only required to prepare group accounts if required under the Companies Acts. As a result there will still be exemptions from consolidation for small and medium sized groups.

What is a subsidiary?

A subsidiary is an entity that is controlled by a parent. **Control** is the power to govern the financial and operating policies of an entity so as to obtain economic benefits from its activities. In addition a special purpose entity must be consolidated when the substance of the relationship indicates that it is controlled by the 'parent' entity.

Normally control is presumed to exist when the parent owns, directly or indirectly, more than 50% of the voting power unless it can be demonstrated that ownership does not constitute control. However, control also exists when the parent owns half or less of the voting power of an entity but it has:

(a) power over more than 50% of voting rights via an agreement with other investors; or

(b) power to govern the financial and operating policies under statute or agreement; or

(c) power to appoint or remove the majority of the members of the board of directors; or

(d) power to cast the majority of votes at meetings of the board of directors

If a special purpose entity has been established to accomplish a narrow objective (e.g. to effect a lease – could be a trust, partnership or unincorporated entity – usually strict requirements on their operations) then it must be included in the consolidated financial statements. Thus, in addition to (a) to (d) above the following circumstances may indicate that an entity controls an SPE:

(a) the activities of the SPE are conducted according to the specific business needs of the entity; or

(b) the entity has ultimate decision making powers over the SPE; or

(c) the entity has rights to obtain a majority of the benefits of the SPE and is exposed to the majority of risks

(d) the entity retains a majority of residual or ownership risks related to the SPE or its assets.

Consolidation procedures

The group is presented as a single economic entity and FRS 102 applies the normal consolidation procedures:

(a) combine the financial statements of the parent and its subsidiaries on a line by line basis

(b) eliminate the parent company's investment in each subsidiary and the parent's portion of equity of each subsidiary

(c) measure and present non-controlling interests (formerly known as minority interests) in profit/loss separately from the parent's interest but as an allocation of profit NOT an expense in arriving at profit

(d) measure and present non-controlling interests in the net assets separately from the parent entity's equity to include its share of net assets at acquisition as well as its share of changes in equity since the date of combination. However it must be recorded within equity.

The split of profit/loss between the parent's and the non-controlling interests are determined on basis of existing ownership interests and must ignore the possible exercise of any options/convertibles.

Intragroup balances and transactions

These are eliminated in full. In addition, intragroup losses may indicate an impairment that requires recognition in the consolidated accounts.

Uniform reporting date and accounting policies

A parent and its subsidiaries should adopt the same reporting date unless this is impracticable and also the group must adopt uniform accounting policies and therefore appropriate adjustments need to be made in preparing the consolidated accounts.

Acquisition and disposal of subsidiaries

The income and expenses of a subsidiary are only consolidated from the date of acquisition until the parent ceases to control the subsidiary. Any difference between the proceeds of sale and the carrying amount of the subsidiary at the date of disposal is recorded as a gain/loss in the consolidated statement of comprehensive income (or in the income statement if presented). However, unlike the full standards, cumulative exchange differences originally recorded in reserves are NOT recycled.

If an entity ceases to be a subsidiary but the parent still holds an investment in that entity it should be accounted for as a financial asset regarding Section 11 *Basic Financial Instruments* provided it is not an associate or joint venture. The carrying amount is then taken as the cost on initial measurement of the financial asset.

Non-controlling interests in subsidiaries (NCI)

As previously noted, these should be disclosed separately, within equity, from the parent shareholder's equity and in the income statement their share of profit/loss should also be disclosed separately. In addition, NCI must also be separately disclosed in the statement of comprehensive income, if presented.

Disclosure in consolidated financial statements

There is a limited amount of disclosure required but the following must be disclosed:

- **(a)** the fact that the statements are consolidated
- **(b)** the basis for concluding control exists when less than 50% of the votes are held
- **(c)** any difference in the reporting date of a parent and its subsidiaries
- **(d)** the nature and extent of any significant restrictions on the transfer of funds
- **(e)** the name of any subsidiary excluded and reason

Individual and Separate financial statements

Separate financial statements

FRS 102 does not require a parent to publish separate financial statements for itself or its subsidiaries. When a parent prepares separate financial statements and describes them as following the FRS it must account for its investments in subsidiaries, associates and jointly controlled entities:

- **(a)** at cost less impairment; or
- **(b)** at fair value with changes recognised in profit or loss; or
- **(c)** at fair value with changes recognised in other comprehensive income

The same accounting policy must be adopted for all investments in a single class but an entity can elect for different policies for different classes of investments.

The following must be disclosed:

- **(a)** that the statements are separate financial statements, and
- **(b)** a description of methods used to account for investments in subsidiaries, jointly controlled entities and associates.

Combined financial statements

This is a single set of financial statements of two or more entities controlled by a single investor. The FRS does not require combined statements. The controlling investor may prepare combined statements if they have common objectives and economic interests and are managed jointly.

If combined statements are prepared and are described as complying with the FRS it must comply with all requirements of the FRS. Intercompany balances must be eliminated, the combined entities must use the same reporting date unless impracticable and all must follow uniform accounting policies.

The following also needs to be disclosed:

- **(a)** the fact that the financial statements are combined
- **(b)** the reason why combined statements are prepared
- **(c)** the basis for determining which entities are included in the combined statements
- **(d)** the basis of preparation of combined statements
- **(e)** the related party disclosures required by Section 33

Intermediate payment arrangements

This part of Section 9 is only contained in FRS 102 (not the IFRSSME). Normally it includes arrangements whereby a reporting entity makes payments into a trust to accumulate assets to pay its employees or suppliers for services/ goods rendered. Often the beneficiaries are unknown at the time the payments are made into the trust.

There is a rebuttable presumption that any payments represent an exchange of one asset for another and therefore it should not be expensed. However, this may be rebutted if the reporting entity can demonstrate that it will not receive any future economic benefits from the amounts paid nor does it have control over the right or other access to the future economic benefits it is expected to receive.

In the former case an asset only ceases to exist to be recognised when it vests unconditionally in identified beneficiaries.

Associates and Joint Ventures

Associates

Associates defined

These are entities over which an investor exercises significant influence and are neither subsidiaries nor joint ventures. Significant influence requires the power of an investor to participate in the financial and operating policy decisions of the associate but it does not give the entity control or joint control over those decisions.

It is assumed that a 20% plus voting power gives significant influence and conversely a 20% or less voting power does not provide significant influence

Measurement after initial recognition

Under FRS 102 an investor should account for associates only by applying equity accounting in its consolidated accounts. Under the equity method of accounting, an equity investment is initially recognised at the price paid to acquire the investment (including transaction costs) and is subsequently adjusted to reflect the investor's share of the **profit or loss** and **other comprehensive income** of the associate.

Any distributions received from the associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be required as a consequence of changes in the associate's equity arising from items of other comprehensive income.

Although potential voting rights are considered in deciding whether significant influence exists, an investor must measure its share of profit or loss of the associate and its share of changes in the associate's equity on the basis of present ownership interests.

On acquisition of an associate, an investor must account for any goodwill created on the excess price paid over the fair value of the net identifiable assets acquired.

The rules are similar to IAS 28 so an investor must adjust its share of the associate's profits or losses after acquisition to account for additional depreciation on the basis of the excess of their fair values over their carrying amounts at the time the investment was acquired.

If there is an indication that an investment in an associate may be impaired, then an investor must test the entire carrying amount of the investment for impairment as a single asset. Any goodwill in the associate is not tested separately for impairment but, rather, as part of the test for impairment of the investment as a whole.

Unrealised profits and losses resulting from both upstream (associate to investor) and downstream (investor to associate) transactions are eliminated but only to the extent of the investor's interest in the associate.

In applying the equity method, the investor must use the financial statements of the associate as of the same date as the financial statements of the investor unless it is **impracticable** to do so. If it is impracticable, the investor should use the most recent available financial statements of the associate, with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends.

The rules in IAS 28 regarding losses in excess of the carrying amount of the investment and the need to adjust the associates accounting policies in line with the investor are the same in the FRS. There are also similar rules as to when to discontinue the equity method e.g. loss of significant influence, disposal or conversion into a subsidiary.

An investor must present their investment in associates as non-current assets.

Disclosures

Investors must disclose the following in relation to their investment in associates:

- **(a)** its accounting policy
- **(b)** the carrying amount of investments in associates
- **(c)** the fair value of investments in associates for which there are published prices.

Joint ventures

Joint ventures defined

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity subject to joint control – can be jointly controlled operations, jointly controlled assets or jointly controlled entities. Joint control is a contractually agreed sharing of control over an economic activity – only exists when strategic financial and operating decisions require the unanimous consent of all parties sharing control.

Jointly controlled operations

An investor can be involved in an operation involving the use of assets and other resources rather than the establishment of a separate entity. The agreement usually provides details of the means by which revenue from the sale of a joint product and any expenses are shared among the venturers.

In that situation a venturer should recognise the following in its financial statements:

- **(a)** the assets it controls and liabilities it incurs; and
- **(b)** the expenses it incurs and its share of the income it earns from the sale of goods and services by the joint venture.

Jointly controlled assets

Some joint ventures involve joint control over one or more assets. A venturer has to recognise the following in its financial statements:

- **(a)** its share of any jointly controlled assets, classified as to their nature;
- **(b)** any liabilities it has incurred;
- **(c)** its share of any liabilities incurred jointly with other venturers;
- **(d)** any income from the sale or use of its share of the output of the joint venture together with its share of any expenses incurred by the joint venture; and
- **(e)** any expenses it has incurred in respect of its interest in the joint venture.

Jointly controlled entities

This involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. It operates like any other entity except there is a contractual arrangement involving joint control by the venturers.

Although the IFRSSME permits the adoption of the same three options as for associates FRS 102 also insists that the equity method be the only permitted method for an entity preparing consolidated accounts. The procedures for equity accounting are identical to associates.

Disclosures

An investor in a joint venture must disclose:

- **(a)** the **accounting policy** it uses for recognising its interests in jointly controlled entities;
- **(b)** the **carrying amount** of investments in jointly controlled entities;
- **(c)** the fair value of investments in jointly controlled entities accounted for using the equity method for which there are published price quotations; and
- **(d)** the aggregate amount of its commitments relating to joint ventures.

For jointly controlled entities accounted for in accordance with the equity method, the venturer must also make the disclosures required by Section 14 Associates for equity accounted investments.

Summary

Overall there are not many differences between local Irish accounting standards and FRS 102 particularly as the Financial Reporting Council (FRC) has incorporated the same exemptions from consolidation that are currently contained in the Companies Acts and it has disallowed the alternative cost and fair value models permitted by the IFRSSME. By insisting on the equity method for associates and joint ventures it ties in with the requirement in FRS 9 Associates and Joint Ventures.

Section 19

Business Combinations

What is a Business combination?

A business combination is defined in FRS 102 as 'a bringing together of separate entities into one reporting entity'. In a combination one party (known as 'the acquirer) obtains control over the financial and operating policies of another party (known as 'the acquiree').

The accounting consequences only arise at what is termed the date of acquisition i.e. the date that the acquirer effectively obtains control over the operating and financial policies of the acquiree.

There are many different ways to structure a business combination e.g. a takeover of another entity, the acquisition of the net assets of the acquiree, the assumption of liabilities of the acquiree or even what is sometimes referred to as a merger or pooling of interests where both companies go forward as if they have always been one team from the outset. Unfortunately, the actual technique of merger accounting which has been relatively popular in Ireland (e.g. Glanbia Plc – merger of Avonmore Creameries and Waterford Foods and the Irish Life and Irish Permanent merger) has now been banned by the IASB for both full IFRS and FRS 102 so all genuine combinations will have to be accounted for using only the acquisition method of accounting. The only exception is when a group reorganisation takes place which really involves reorganising the existing group companies around a different holding company but there is no external body involved and therefore not a real combination between two separate companies.

What is the appropriate accounting treatment?

As stated in the previous paragraph all genuine business combinations will now have to be accounted for using the *acquisition method*. Those companies, however, that have adopted merger accounting in the past will not have to restate those past combinations as there are specific transitional relief provisions on the transition from local Irish GAAP to the new FRS.

Under the acquisition method the following steps should be followed in accounting for a combination:

- **(a)** identify one of the two parties as the acquirer
- **(b)** identify the date of acquisition
- **(c)** measure the cost of the business combination that the acquirer has paid to gain control over the acquiree i.e. the purchase consideration at the date of acquisition; and
- **(d)** allocate, also at the date of acquisition, the purchase price to the net assets acquired including any contingent liabilities assumed.
- **(e)** any residual remaining after deducting (d) from (c) will give rise either to a positive debit balance (goodwill) or negative credit balance (negative goodwill)

(a) Identifying the acquirer

An acquirer must be identified for all business combinations and is the party which obtains control over the other party. Control is defined as the power to govern the operating and financial policies of an entity so as to gain benefits from its activities.

Normally it is fairly obvious in a straight takeover as to who is the acquirer and who is the acquiree but it can be difficult where the two combining companies are roughly the same size and there is an exchange of shares between the two. The standard therefore provides preparers with some indications on how to identify an acquirer in those situations. These, however, must only be regarded as helpful guidelines. Ultimately it will be the decision of the two parties and it is important that the decision reflects the substance of the new arrangement.

The following are the indicators provided in the standard to determine an acquirer:

- **(a)** an acquirer is identified if the fair value of one of the combining entities is significantly greater than the other; or
- **(b)** if the combination is via an exchange of voting ordinary shares for cash, the entity giving up cash is usually the acquirer; or
- **(c)** if the combination results in the management of one of the parties being able to dominate the selection of the management team of the combined entity then that party is usually the acquirer

(b) Date of acquisition

This is an important date as the fair value exercise resulting in the calculation of goodwill/negative goodwill can only take place at this date. It is the date that the acquirer gains control over the operating and financial policies of the acquiree for the first time. It might coincide with the date that consideration passes between the two companies or the date of agreement between the two parties. However, that is not always the case. Judgment will be required as to when control over the policies actually takes place. Only assets and liabilities which exist at that date may be brought into the calculation of goodwill.

(c) Cost of a business combination (i.e. purchase consideration)

The cost of a business combination is the sum of:

- **(a)** the fair value at the date of exchange of assets given, liabilities incurred and equity issued by the acquirer in exchange for control of the acquiree; plus
- **(b)** any directly attributable costs

One real problem is how to account for earn out clauses which are extremely popular in practice. These are set up in order to retain the original goodwill of the previous owners and give the new owners time to replace that goodwill/reputation with their own. The previous owners are therefore set profit targets which provided they are achieved will result in additional consideration being paid out to the original owners.

Normally these are set at fairly reasonable levels and there would be an expectation that the targets will be achieved. If that is the case then these should also be included in the cost of the combination as long as they can be reliably measured. If, however, it is not recognised at the acquisition date, but subsequently it can be measured reliably, and is probable then the additional consideration should be adjusted to the cost of the combination.

(d) Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed (i.e. fair value of assets acquired)

The cost of the combination should be allocated to the identifiable assets and liabilities at their fair value at the date of the business combination. Any difference between the cost and the acquirer's interest in the net fair value of identifiable net assets is accounted for as goodwill/negative goodwill.

However, identifiable net assets can only be recognised separately if they satisfy the following criteria at that date:

- **(a)** It is **probable** that **future economic benefits** will flow to the acquirer and the fair value can be reliably measured; and
- **(b)** it is **probable**, in a **liability**, that an **outflow of resources** will be required to settle the obligation and the fair value can be reliably measured; and
- **(c)** for **intangible assets or contingent liabilities**, their **fair value** can be **reliably measured**.

The statement of comprehensive income must only incorporate the acquiree's profits and losses after the acquisition date based on the costs identified at the acquisition date e.g. depreciation should be based on the fair values at that date and not on the original historic costs.

The application of the acquisition method starts from the date of acquisition and it is from this date that the results and changes in net assets must be reflected in the consolidated financial statements.

At the date of acquisition an acquirer can only recognise separately the identifiable assets, liabilities and contingent liabilities of the acquiree at acquisition date and satisfy the recognition criteria at that date.

Therefore:

- **(a)** The acquirer should recognise liabilities for terminating the activities of an enterprise only when the acquiree has, at acquisition date, an existing liability for restructuring; and
- **(b)** the acquirer, when allocating cost, must not recognise liabilities for future losses nor provisions for future overhaul/maintenance etc as these are mere intentions and not legal or constructive obligations.

If the initial accounting is incomplete by the end of the reporting period in which the combination took place, provisional amounts may be used but within the next 12 months the acquirer must retrospectively adjust the provisional amounts to reflect any new information obtained. Any adjustments after that period are accounted for as errors and will require prior period adjustments.

There are some exceptions to the basic principle that the identifiable assets and liabilities must be measured at their fair value at the date of acquisition. For example, there is ample opportunity to bring on board such intangibles as brand names, customer relationships, non competition agreements etc as well as contingent liabilities as long as they can be reliably measured. However, some assets and liabilities would not be permitted e.g. the assembled workforce and economies of scale would have to be reflected as part of goodwill and not individually reported as separate intangible assets.

(e) Residual – Goodwill or negative goodwill

The acquirer at acquisition date should recognise goodwill as an asset if the fair value of the consideration paid has exceeded the fair value of the net assets acquired and similarly if the reverse occurs then any excess fair value of the assets acquired over the purchase consideration must be treated as negative goodwill.

After initial recognition, goodwill should be measured at cost less accumulated amortisation and impairment losses. If there is no reliable estimate of the useful life of goodwill then the life should be presumed to be restricted to a maximum 5 year period unless a reliable measure of the goodwill life is available.

If an acquirer's interest, however, in the fair value of the net assets exceeds the price paid this will create a credit negative goodwill or badwill balance. In these circumstances, the acquirer must:

(a) First reassess the identification and measurement of the net identifiable assets acquired and the measurement of cost to ensure that they have been correctly assessed; and if still negative then

(b) recognise any excess after reassessment to profit in the periods in which the non-monetary assets acquired are recovered. That is similar to the FRS 10 current approach adopted in these islands. It does mean entering negative goodwill as a credit balance initially on the asset side of the balance sheet.

What disclosure is necessary for a business combination?

For business combinations occurring during the reporting period

For each combination that has occurred during the period, an acquirer should disclose the following:

(a) the names and descriptions of the combining entities

(b) the date of acquisition

(c) the percentage of voting equity acquired by the acquirer

(d) the cost of the combination and description of its components

(e) the amounts recognised for each class of acquiree's assets, liabilities and contingent liabilities, including goodwill acquired

(f) the useful life of goodwill if this exceeds 5 years with supporting reasons

For all business combinations

A reconciliation of the carrying amount of goodwill at the start and end of the period showing separately:

(a) changes arising from new combinations

(b) impairment losses

(c) disposals of previously acquired businesses

(d) and other changes

Summary

There are very few differences between the current local standards and FRS 102. The key change from the current local standard is the death of merger accounting as one of the two main methods of accounting for business combinations. It was found to be too difficult to police properly as many companies, particularly in the United States were bending the rules to try and the maximize the use of that technique. However, it is still permitted for public benefit entities in the UK and Ireland where two non-profit making entities merge their interests together (see Chapter 10)

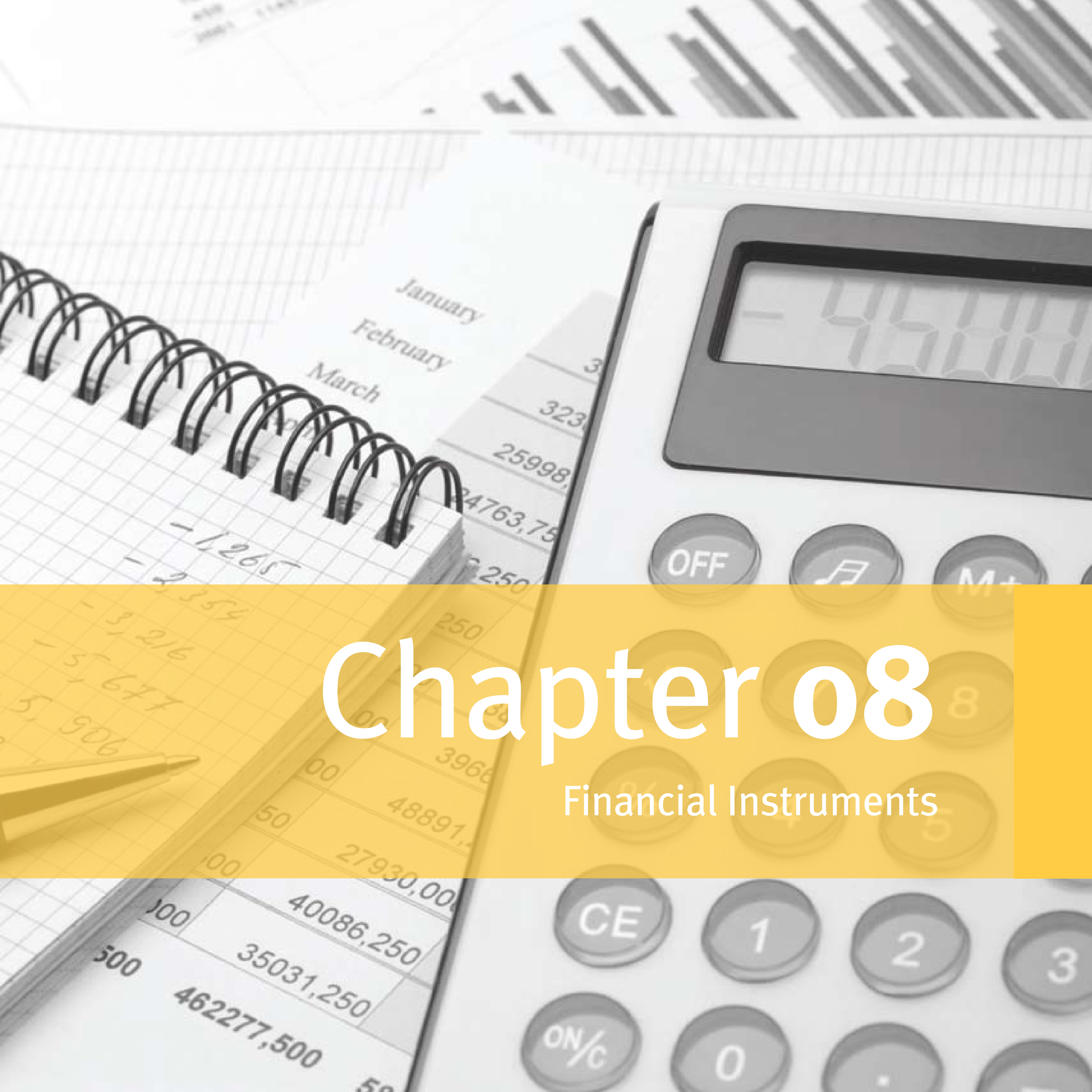
The main benefit arising from not having to apply the full IFRS 3 *Business Combinations* is that reporting entities will be allowed to amortise goodwill rather than having to report a permanent asset on the balance sheet. That means that an annual impairment test will not be compulsory and therefore goodwill would only be treated for impairment if there are general indicators, externally or internally, that the group of assets in which it lies have become impaired.

The other major change is the ability to incorporate more intangibles on to the balance sheet in an acquisition although this is less likely for unlisted companies as they would be unlikely to have the same variety of intangibles as listed companies.

Overall there are a lot of similarities to the existing local standards FRS 10 *Goodwill and other intangible assets, FRS 6 Acquisitions and mergers and FRS 7 Fair values in acquisition accounting.*

Chapter 08

Financial Instruments



Many accountants, both in practice and in industry, struggle with the complexity of the various instruments available and how they should be accounted for in the financial statements. The International Accounting Standards Board (IASB) in their IFRSSME and, with minimum changes, the Financial Reporting Council (FRC) in FRS 102 have taken a very sensible approach to the subject. They have offered preparers a choice of opting for the current full IAS 39 provisions (including additional disclosures under the FRS 102 standard) or to stay within FRS 102 and apply Sections 11 and 12 of that standard instead. Most companies will invariably adopt the easier approach of staying within Sections 11 and 12. In addition, as FRS 102 now permits non listed financial institutions to adopt FRS 102, those institutions will have to incorporate additional disclosures contained in Section 34 of that standard.

Both the IASB and the FRC have accepted the need for as much simplification in accounting for financial instruments as possible and have decided to break up the subject into two separate sections – one dealing with basic financial instruments and the second covering the more complex financial assets and liabilities including how to account for hedging activities. It is believed that most small and medium sized concerns will not be involved in the creation of complicated instruments and therefore they may never need to apply Section 12 of the standard.

The FRS does, in addition, make reference on how to account for concessionary loans which many public benefit entities may get involved with and these are covered in Section 34.

Section 11

Basic Financial Instruments

A financial instrument is defined in Section 11 as 'a contract giving rise to a financial asset in one entity's books and a financial liability or equity in another'.

Section 11 requires the adoption of an amortised cost model for all basic instruments except for a few unusual items such as non-convertible and non-puttable preference shares. In addition, if any instruments that are within Section 12 but where there is no reliable fair value available for them, these should also be recorded at amortised cost.

Examples of basic instruments would include cash, demand deposits, accounts payable, and bonds.

However, examples of financial instruments that would NOT normally be included in Section 11 would include asset backed securities, options, warrants, futures contracts, forward contracts, interest rate swaps and financial instruments qualifying as hedging instruments.

Section 11 expressly excludes group investments, an entity's own shares, pension schemes, leases, and insurance contracts as these would generally be covered by other more specific sections of the standard.

Initial recognition of financial assets and liabilities

A financial instrument may only be recognised when an entity becomes a party to the contractual provisions of the instrument.

Initially and at each reporting date an entity should measure the financial instruments at transaction price unless it is a financing transaction e.g. payment deferred beyond normal business terms or financed at non market rate. In that case it must be measured at the present value of future payments discounted at a market rate of interest for a similar debt instrument (i.e. the amortised cost approach).

Subsequent measurement

At the end of each reporting period, reporting entities must measure financial instruments as follows, without any deduction for transaction costs on disposal:

- Debt instruments that meet the conditions in Section 11 to be valued at amortised cost must adopt the effective interest method.

- Debt instruments that are classified as current assets or current liabilities should be measured at the amount of consideration expected to be paid or received unless the arrangement constitutes, in effect, a financing transaction. If the arrangement constitutes a financing transaction, the debt instrument is measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

The one exception is for investments in non-convertible preference shares and non-puttable ordinary or preference shares which must be measured at fair value, if reliably measured. Otherwise they are recorded at cost less impairment.

For those recorded at cost or amortised cost an annual review for impairment or uncollectability must be carried out.

Amortised cost and effective interest method

The amortised cost of a financial asset or financial liability at each reporting date is the net of the following amounts:

(a) the amount initially recognised for the financial asset or financial liability,

(b) minus any repayments of the principal,

(c) plus or minus the cumulative amortisation using the effective interest method of any difference between the amount at initial recognition and the maturity amount,

(d) minus, in the case of a financial asset, any reduction (directly or through the use of an allowance account) for impairment or uncollectibility

Financial assets and financial liabilities that have no stated interest rate and are classified as current assets or current liabilities are initially measured at an undiscounted amount.

Example of determining amortised cost for a five-year loan using the effective interest method

On 1 January 2013, an entity acquires a bond for Currency Units 900, incurring transaction costs of 50. Interest of 40 is receivable annually, in arrears, over the next five years (31 December 2013–31 December 2017).
The bond has a mandatory redemption of 1,100 on 31 December 2017.

Year	Carrying amount at beginning of period €	Interest income at 6.9583%* €	Cash inflow €	Carrying amount at end of period €
2013	950.00	66.10	(40.00)	976.11
2014	976.11	67.92	(40.00)	1,004.03
2015	1,004.03	69.86	(40.00)	1,033.89
2016	1,033.89	71.94	(40.00)	1,065.83
2017	1,065.83	74.16	(40.00)	1,100.00
			(1,100.00)	0

* The effective interest rate of 6.9583 per cent is the rate that discounts the expected cash flows on the bond to the initial carrying amount:
$40/(1.069583)^1 + 40/(1.069583)^2 + 40/(1.069583)^3 + 40/(1.069583)^4 + 1{,}140/(1.069583)^5 = 950$

Source: FRS102 The FRS applicable in the UK and Republic of Ireland (FRC, March 2013)

Impairment of financial instruments measured at cost or amortised cost

Recognition

At the end of each reporting period impairment should be reviewed for all financial assets measured at cost or amortised cost. If there is objective evidence of impairment an impairment loss should be recognised immediately in profit or loss. Objective evidence includes observable data about the following loss events:

- significant financial difficulty of the issuer
- breach of contract e.g. default
- creditor has granted a debtor a concession not normally considered
- probable a debtor will enter bankruptcy
- disappearance of an active market due to a debtor's financial difficulties
- measurable decrease in estimated future cash flows from a group of financial assets even though individual assets cannot be identified e.g. adverse national economic conditions

Other factors could include technological, market, economic or legal/ environmental factors in which the issuer operates.

Financial assets that are significant should be disclosed separately but others may be grouped in similar credit risk categories.

Measurement

An impairment loss is measured as follows:

- For amortised cost less impairment – the difference between the carrying amount and the present value of estimated future cash flows discounted at the original effective discount rate; and
- for cost less impairment – the difference between the carrying amount and the best estimate of the amount that would be received for the asset if it were sold at the reporting date.

Reversal

If subsequently the impairment loss decreases (e.g. an improvement in a debtor's credit rating) the loss should be reversed either directly or by adjusting an allowance account. It should not result, however, in creating a carrying amount exceeding what it would have been had the impairment not previously been recognised. The reversal should be recorded in profit/loss.

Fair Value

For a couple of unusual instruments (see earlier) Section 11 requires a fair value measure, if reliably measured. The following hierarchy should be used in evaluating fair value:

- the best evidence of fair value is a quoted price in an active market.
- the price of a recent transaction for an identical asset
- If there is no active market nor a recent transaction an entity can adopt a valuation technique to estimate what the transaction price would have been on the measurement date in an arm's length exchange.

Derecognition of a financial asset

A financial asset may only be derecognised from the balance sheet when:

- the contractual rights to cash flows from a financial asset expire or are settled; or
- the entity transfers to another party all significant risks and rewards relating to the asset (e.g. a factoring of debts without recourse); or
- the entity, despite retaining some significant risks and rewards, has transferred control of an asset to another party and the other party has the practical ability to sell the asset in its entirety to an unrelated third party.

In this case the assets should be derecognised and any rights and obligations retained separately recorded

The carrying amount of a transferred asset should be allocated between rights etc retained and those transferred based on their relative fair values at the transfer date. New rights etc should be recorded at their fair values at that date with any difference being recognised in profit and loss.

Derecognition of a financial liability

A liability should only be derecognised when it is extinguished, cancelled or expired.

If an existing borrower and lender exchange debt instruments with substantially different terms it should account for the transaction as an extinguishment of the original financial liability and recognition of a new financial liability. Similarly a substantial modification should result in the same accounting treatment.

Any difference between the carrying amount of a financial liability extinguished and consideration paid is reported in profit/loss.

Disclosures

Disclosure of accounting policies for financial instruments

The entity should disclose the measurement basis and other accounting policies that are relevant in understanding the financial statements.

Statement of financial position – categories of financial assets and financial liabilities

The carrying amounts of each of the following categories of financial assets and liabilities, in total, and by each significant type should be disclosed on the face of the statement of financial position or in the notes:

- financial assets measured at fair value through profit or loss
- financial assets measured at amortised cost
- equity instruments measured at cost less impairment
- financial liabilities measured at fair value through profit or loss
- financial liabilities that are not held as part of a trading portfolio and are not derivatives must be shown separately
- financial liabilities measured at amortised cost; and
- loan commitments measured at cost less impairment

Information must also be disclosed to enable users to evaluate the significance of financial instruments for financial position and performance e.g. the terms and conditions of long term debt, restrictions, repayment schedules etc.

For all financial assets and liabilities measured at fair value, the basis for determining that value should be disclosed giving details of active markets or assumptions used in valuation techniques.

If a reliable measure of fair value is no longer available that fact should be disclosed.

There are also requirements to disclose the policies adopted on derecognition of financial instruments, details of defaults on loans payable and the back up to items recorded in the income statement or directly in equity.

In FRS 102 there are also additional disclosure requirements for financial instruments that are not equity instruments, are not held as part of a trading portfolio and are not derivatives.

Section 12

Other Financial Instruments Issues

Section 12 applies to the more complex financial instruments and transactions. That will include all instruments that are not permitted to be recorded as basic in Section 11.

Initial recognition of financial assets and liabilities

Similar to Section 11 a financial instrument is only recognised when an entity becomes a party to the contractual provisions of that instrument.

Initial Measurement

Initially an entity should measure Section 12 instruments at **fair value** which is normally the transaction price.

Subsequent measurement

At the end of each reporting period, all financial instruments within the scope of Section 12 must be remeasured at **fair value** and any changes in fair value recognised in profit or loss, with the exception of:

- equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably, and
- contracts linked to such instruments that, if exercised, will result in delivery of such instruments, must be measured at cost less impairment.

In addition, if a reliable measure of fair value is no longer available for an equity instrument that is not publicly traded but is measured at fair value through profit or loss, its fair value at the last date the instrument was reliably measurable is treated as the cost of the instrument. A reporting entity must measure the instrument at this cost amount less impairment until a reliable measure of fair value becomes available.

Fair value

Reporting entities must apply the guidance on fair value as already shown earlier in Section 11.

Transaction costs, however, are NOT recorded in the initial measurement of financial assets and liabilities that will be measured subsequently at fair value through profit or loss. If payment for an asset is deferred or is financed at a rate of interest that is not a market rate, the entity should initially measure the asset at the present value of the future payments discounted at a market rate of interest.

Impairment of financial instruments measured at cost or amortised cost

If an entity has to resort to cost/amortised cost it must apply the guidance on impairment of a financial instrument measured at cost in Section 11.

Derecognition of a financial asset or financial liability

Similarly reporting entities must apply the same derecognition principles in Section 11 in deciding whether or not to derecognise financial assets and financial liabilities to which this section applies.

Hedge accounting

Section 12 permits a hedging relationship between a hedging instrument and a hedged item to be designated and, if specified criteria are met, then a gain/loss on the instrument and on the hedged item may be recognised in profit/loss at the same time.

To qualify an entity must comply with all of the following conditions:

- The relationship is designated and documented so risk, hedging instrument and hedged item are clearly identified.
- The hedged risk is one of the risks specified below:

    Interest rate risk of a debt instrument measured at amortised cost

    Foreign exchange or interest rate risk in a firm commitment or highly probable forecast transaction

    Commodity price risk that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or

    Foreign exchange risk in a foreign operation.
- The hedging instrument must also meet all of the following terms and conditions:
    - Interest rate swap, foreign currency swap, forward foreign exchange contract or commodity forward exchange contract which is expected to be highly effective
    - Involves an external party
    - Its notional amount is equal to the designated amount of the principal or notional amount of the hedged item
    - Has a specified maturity date not later than the maturity of the financial instrument being hedged, the expected settlement of the commodity purchase commitment or the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged
    - Has no prepayment, early termination or extension features

There are additional detailed rules on hedges of fixed interest risks of a recognised financial instrument or commodity price risk of a commodity held and also for hedges of variable interest rate risk of a recognised financial instrument, foreign exchange risk or commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation.

Disclosures

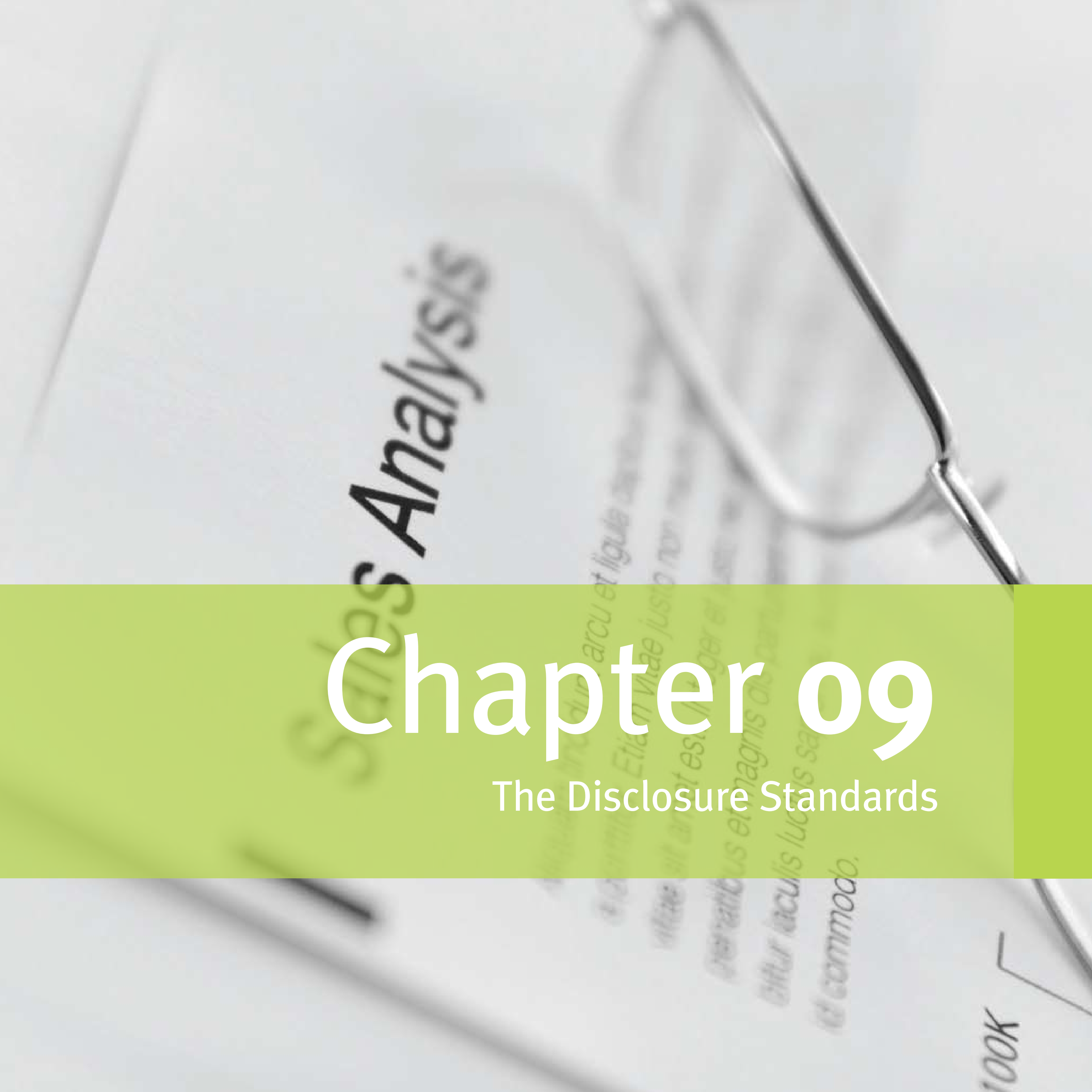
A reporting entity must provide all the disclosures required by Section 11, but in addition for hedge accounting an entity should disclose the following separately for hedges of each of the four types of risks:

- **(a)** a description of the hedge
- **(b)** a description of the financial instruments designated as hedging instruments and their fair values at reporting date; and
- **(c)** the nature of the risks being hedged including a description of the hedged item

There are additional disclosures for a hedge of fixed interest rate risk or commodity price risk and for a hedge of variable interest rate risk, foreign exchange risk, commodity price risk or highly probable forecast transaction or a net investment in a foreign operation.

Summary

There is no doubt that financial instruments pose considerable problems both in terms of understanding how each product works but also in how to account for them so as to provide a true and fair view. The IASB and the FRC have been able to reduce the complicated material in full IFRS into two fairly short succinct chapters. In addition, by splitting the more complex instruments away from basic instruments it should mean that unless a reporting entity gets involved in derivative and hedging activity the accounting treatment should be fairly straightforward. However, one aspect which could pose problems is getting used to applying the effective interest method for assets held at amortised cost.



Chapter 09

The Disclosure Standards

Section 33

Related Party Disclosures

This section of FRS 102 requires an entity to include disclosures to draw attention to the users of financial statements of the possibility that its financial position and performance could be affected by the existence of related parties and by transactions and outstanding balances with such parties. A major exemption, however, in the standard is that it does not require transactions between two or more members of a group to be disclosed provided a subsidiary is wholly owned.

Related party defined

The definition of a related party is largely governed by the Companies Acts. A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity). It does include individuals or close members of that person's family if that person can exercise control, significant influence or joint control over the reporting entity, or is a member of the key management personnel of the reporting entity or of its parent.

In effect it covers associates, joint ventures, subsidiaries, key management personnel and pension schemes. However, an assessment of the relationship must be made and not merely its legal form when deciding whether or not a relationship exists i.e. it applies the doctrine of substance over form.

The following are not necessarily related parties:

- two entities having common directors or key management
- two venturers simply because they share joint control over a joint venture
- any of the following simply by having normal dealings with the reporting entity:
    - (i) providers of finance
    - (ii) trade unions
    - (iii) public utilities; and
    - (iv) government departments and agencies
- economically dependent customers, suppliers, franchisors etc

FRS 102 has clarified that an associate includes subsidiaries of that associate and a joint venture includes its subsidiaries as well i.e. an associate's subsidiary and the investor DO HAVE related party implications.

Disclosure

1. Disclosure of parent-subsidiary relationships

Relationships between parents and subsidiaries should be disclosed irrespective of whether or not transactions exist between the parties. The name of the entity's parent should be disclosed, and if different, its ultimate controlling party. If neither company publishes accounts for public use then the name of the next most senior parent that does so should be disclosed.

2. Disclosure of key management personnel compensation

These are those persons having the authority and responsibility to plan, direct and control the activities of the entity. Compensation includes all employee benefits earned by employees in exchange for services rendered by them to the entity. Reporting entities should disclose key management personnel compensation, in total. It is not required either individually or by nature of compensation expensed.

3. Disclosure of related party transactions

A related party transaction is a transfer of resources, services or obligations between related parties regardless of whether a price is charged.

The nature of the relationship as well as transactions and outstanding balances should be provided. These are in addition to the key management personnel disclosure above. At a minimum the disclosures must include:

- the amount of the transactions
- the amount of outstanding balances and their terms and conditions and details of any guarantees given or received
- any provisions for uncollectible receivables; and
- the expense recognised for bad and doubtful debts due from related parties

There should be separate disclosure for each of the following categories:

- associates and joint ventures
- key management personnel; and
- other related parties

The following are examples of transactions that are disclosed if they are with a related party:

- purchases or sale of goods or property
- rendering or receiving of services
- leases
- transfers of research and development, under licence agreements or transfers under financing arrangements
- provision of guarantees
- settlement of liabilities on behalf of the entity
- participation by a parent or subsidiary in a defined benefit plan

Similar items may be disclosed in aggregate except when separate disclosure is necessary to understand the overall effects on the financial statements.

Section 32

Events after the end of the Reporting Period

These are defined as those events, both favourable and unfavourable, between the end of the reporting period and the date that the financial statements are authorised for issue.

There are two types:

Adjusting events – provide evidence of conditions existing at the period end; and

Non adjusting events – indicative of conditions arising after the period end.

Events include all those incurred up to the date when the financial statements are authorised.

Recognition and measurement

Adjusting events after the end of the reporting period

Reporting entities should adjust the amounts recognised in the financial statements to reflect adjusting events.

The following are typical examples:

- The settlement of a court case confirming a present obligation – must adjust provision or create new one – not merely disclose a contingent liability.
- The receipt of information that an asset was impaired e.g. bankruptcy of customer, sale of obsolete inventories at NRV.
- Determination of cost of assets purchased or proceeds of assets sold.
- Determination of profit sharing or bonus payments if a legal or constructive obligation exists.
- Discovery of fraud or errors showing the financial statements to be incorrect.

By their nature they are not normally material and do not require any specific disclosure.

Non adjusting events after the end of the reporting period

Companies should not adjust the financial statements for these events. An example would be a decline in the market value of investments post balance sheet date as this does not reflect their value at the end of the reporting period but circumstances that have arisen subsequently. They do not represent conditions existing at the year end.

Dividends

If an entity declares dividends after the period end no liability should be recognised at the end of the reporting period. However, investors like to know what dividend they are likely to receive so they may be shown as a segregated component of retained earnings at the end of the reporting period.

Disclosure

Date of authorisation for issue

An entity should disclose the date when the financial statements are authorised and the names of those who gave that authorisation. In addition, if the owners or others have powers to amend the financial statements after that date, that fact must be disclosed. This would be rarely found in practice

Non adjusting events after the end of the reporting period

An entity must disclose the following for each category of non-adjusting event:

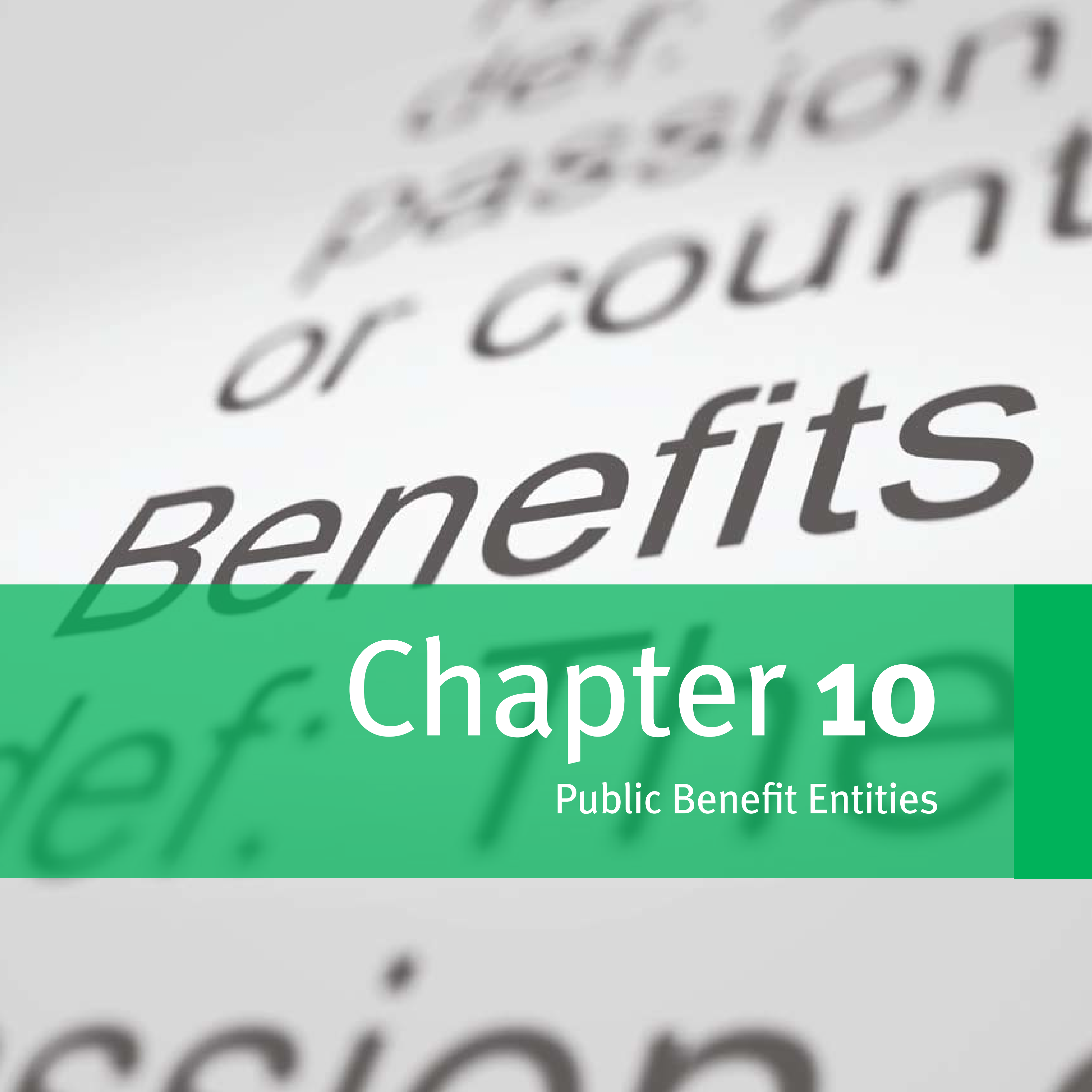
- the nature of the event; and
- an estimate of its financial effect or a statement that such an estimate cannot be made.

The following are typical examples of these events:

- a major business combination or disposal of major subsidiary
- an announcement of a plan to undertake a major restructuring of the entity
- a plan to discontinue an operation
- major purchases of assets
- the destruction of a major production plant by fire
- major ordinary share transactions
- abnormally large changes in asset prices or foreign exchange rates
- changes in tax rates announced
- entering into significant commitments or contingent liabilities
- commencing major litigation

Summary

The two sections in this chapter are very similar to the UK and Irish accounting standards and thus there should be no particular issues in implementing these disclosure sections.



Chapter 10

Public Benefit Entities

Background

In this chapter I wish to focus on the specific aspects of FRS 102 that will apply to public benefit entities only. Originally there was a proposal to introduce a standalone standard for these entities but that has now been abandoned and they are now instead incorporated as special sections within the new standard. In addition the various SORPS in that sector are being internationalised. Certainly the Charity Commissioners for England and Wales are well on their way to revising the Charities SORP and work has also commenced on the Universities SORP.

What is a Public Benefit Entity?

A public benefit entity (PBE) has been defined in FRS 100 as:

> "an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members."

Many people would refer to these entities as not for profit entities and certainly they encompass charities, housing associations and universities and colleges. They do have unique accounting issues that are not covered by the IFRSSME which was designed for private sector profit making entities. A number of these specific issues are now covered in FRS 102 but only PBEs can adopt these specialised sections. They are designated as such throughout the document as PBE sections only.

Before looking at these specialised sections it is important to remember that PBEs should not only follow their specific SORP but also follow ALL of the regulations in FRS 102 i.e. they must read two documents when preparing their financial statements. It is also important to remember that most of the SORPS do not have specific authority in the Republic of Ireland but they are often adopted (particularly by charities) as forming best practice.

Concessionary Loans

The first time that PBEs get a specific mention in FRS 102 is in Section 11 *Basic Financial Instruments* which merely states that PBEs that make or receive concessionary loans must refer to the relevant paragraphs in Section 34 *Specialised Activities* on how to account for such loans. They are therefore outside the scope of financial instruments under the standard.

Section 34 paragraphs 88 to 98 cover the rules in accounting for these loans. Concessionary loans are loans made or received between a PBE and a third party at below the prevailing market rate of interest that are not repayable on demand.

Accounting treatment

A PBE must either adopt:

(a) The recognition, measurement and disclosure requirements in Section 11,which requires initial measurement at fair value and subsequent measurement at amortised cost using the effective interest method or fair value; or

(b) the accounting treatment set out below.

However, a PBE must apply the same accounting policy to both concessionary loans made and received. It is likely that most will adopt the easier option of (b). In that case a PBE making or receiving concessionary loans to a third party must initially measure these arrangements at the amount received or paid and recognise them in the balance sheet (statement of financial position). In subsequent years the carrying amount is then adjusted to reflect accrued interest payable or receivable. To the extent that a loan has been made but is now adjudged to be irrecoverable then an impairment loss must be recognised in income and expenditure.

The loans can be presented either as a separate line item on the face of the balance sheet (statement of financial position) or in the notes. Concessionary loans must be classified separately to disclose amounts repayable within one year and amounts repayable in more than one year.

PBEs must disclose the measurement basis adopted and any other accounting policies which are relevant to understanding these transactions within the financial statements. The PBE should also disclose the terms and conditions of any loans e.g. the interest rate, any security provided and the terms of the repayment as well as the value of concessionary loans committed but not taken up at the year end.

Concessionary loans made or received should be disclosed separately. However multiple loans received or made may be disclosed in aggregate, providing that such aggregation does not obscure significant information.

Incoming resources from non-exchange transactions

These are transactions whereby an entity receives value from another entity without directly giving approximately equal value in exchange or gives value to another entity without directly receiving approximately equal value in exchange.

Non-exchange transactions include donations and legacies.

Recognition and measurement

Receipts of resources from non-exchange transactions should be recognised as follows:

- **(a)** if there are no specified future performance conditions, in income when the resources are receivable
- **(b)** if there are specified future performance conditions, in income only when the performance conditions are met
- **(c)** where resources are received before the revenue recognition criteria are satisfied then a liability must be recognised

The existence of a restriction does not prohibit a resource from being recognised in income when receivable. In addition, when applying the requirements above, an entity must take into consideration whether the resource can be measured reliably and whether the benefits to recognise the resource outweigh the costs.

Where it is not practicable to estimate the value of the resources with sufficient reliability or benefit, the income is included in the financial period when the resources are sold or distributed.

A liability is recognised for any resource with specified performance conditions that becomes repayable due to non-compliance with the performance conditions, when that repayment becomes probable.

Donations that can be reasonably quantified will usually result in the recognition of income and an expense. An asset is recognised only when those services are used for the production of an asset, and the services received will be capitalised as part of the cost of that asset.

Resources from non-exchange transactions should be measured at the fair value of the resources received or receivable.

Disclosure

The nature and amounts of resources receivable from non-exchange transactions recognised in the financial statements must be disclosed as well as any unfulfilled conditions or other contingencies attaching to resources from non-exchange transactions that have not been recognised in income. In addition, an indication of other forms of resources from non-exchange transactions from which the entity has benefited should be provided.

In the Appendix to Section 34 more specific guidance is given on how legacies should be reported in the financial statements. It particularly requires entities to wait until probate and also ensure that there are sufficient assets in the estate to pay the legacy after paying off the estate's liabilities so as to ensure that benefits will probably flow to the entity before recording the legacies in the financial statements. The guidance also requires donated services to be recognised in the financial statements if they can be reasonably quantified, when they are received.

Public Benefit Entity Combinations

FRS 102 has banned the merger technique when dealing with business combinations but in this part of Section 34 PBEs may apply the technique for:

- **(a)** combinations at nil or nominal consideration which are in substance a gift; and
- **(b)** combinations which meet the definition and criteria of a merger However, genuine acquisitions are still accounted for under Section 19 of the FRS.

Combinations that are in substance a gift

These are combinations carried out at nil or nominal consideration that are not fair value exchanges but are, in substance, the gift of one entity to another. In these cases the excess of the fair value of the assets received over the fair value of the liabilities assumed is recognised as a gain. This gain represents the gift of the value of one entity to another and should be recognised as income.

The excess of the fair value of the liabilities assumed over the fair value of the assets received is recognised as a loss. This loss is recognised as an expense.

Combinations that are a merger

A merger is a combination that results in the creation of a new reporting entity formed from the combining parties, in which the controlling parties of the combining entities come together in a partnership for the mutual sharing of risks and benefits of the newly formed entity and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant.

All of the following criteria must be met to meet the definition of a merger:

- **(a)** no party to the combination is portrayed as either acquirer or acquiree;
- **(b)** there is no significant change to the classes of beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination; and
- **(c)** all parties to the combination participate in establishing the management structure of the combined entity – based on consensus between the parties.

Entity combinations that meet all of the three criteria set out above should apply merger accounting as follows:

- Under merger accounting there is no fair value exercise, although adjustments should be made to achieve uniformity of accounting policies.
- The results and cash flows of all combining entities are brought into the financial statements of the new entity from the beginning of the period in which the merger occurs.

The comparative figures should be restated by including the results for all the combining entities for the previous accounting period and their balance sheets (statements of financial position) for the previous reporting date. The comparative figures should be marked as 'combined' figures.

All costs associated with the merger must be charged to income and expenditure.

Disclosure

For each merger in the reporting period the following must be disclosed in the newly formed entity's financial statements:

- **(a)** the names and descriptions of the combining entities or business;
- **(b)** the date of the merger; and
- **(c)** an analysis of the principal components of the current year's primary financial statements.

Summary

It is welcome news that the FRC have decided to incorporate the specialised accounting transactions for PBEs within FRS 102 rather than having those entities having to read two or possibly three (if complying with a SORP) separate documents when preparing those financial statements. It is also welcome news that PBEs will not have to go through the complicated rules on acquisition accounting if two or more charities etc decide to merge their interests.

Although these various accounting treatments are only spelt out for the first time in an accounting standard they are not difficult to follow and most PBEs will already be adhering to the required treatment under the standard.

Chapter 11

Specialised Activities

Specialised Activities

There are a number of specialised topics which are covered either in the full IFRSs or are unique to the UK and Ireland (e.g. heritage assets, additional disclosure for financial institutions etc.) which require to be covered in FRS 102.

1. Agriculture

An entity using FRS 102 that is engaged in agricultural activity must determine its accounting policy for each class of its biological assets.

Recognition

Reporting entities must recognise a biological asset or agricultural produce when, and only when:

(a) the entity controls the asset as a result of past events; and

(b) it is probable that future economic benefits will flow to the entity; and

(c) the fair value or cost of the asset can be measured reliably.

Measurement

Entities must choose as its accounting policy either:

(a) the fair value model; or

(b) the cost model.

In determining fair value, an entity must consider the following:

(a) If an active market exists - the quoted price is the appropriate basis for determining the fair value and if it has access to different active markets, the entity should use the price existing in the market that it expects to use.

(b) If no active market exists – an entity should adopt one or more of the following, when available, in determining fair value:

(i) the most recent market transaction price, provided there has been no significant change in economic circumstances between the date of that transaction and the end of the reporting period;

(ii) market prices for similar assets with adjustment to reflect differences; and

(iii) sector benchmarks such as the value of an orchard expressed per export tray, bushel, or hectare, and the value of cattle expressed per kilogram of meat.

(c) In some cases, the information sources listed in (a) or (b) may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An entity considers the reasons for those differences, to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.

(d) In some circumstances, fair value may be readily determinable without undue cost or effort even though market determined prices or values are not available for a biological asset in its present condition. Entities must consider whether the present value of expected net cash flows from the asset discounted at a current market determined rate results in a reliable measure of fair value.

If the fair value cannot be reliably measured the entity must apply the cost model.

Disclosures – fair value model

The following must be disclosed with respect to its biological assets measured at fair value:

(a) a description of each class of its biological assets

(b) the methods and significant assumptions applied in determining the fair value of each class of biological assets

(c) a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period.

Measurement – cost model

Entities must measure at cost less any accumulated depreciation and any accumulated impairment losses those biological assets whose fair value is not readily determinable without undue cost or effort.

Agricultural produce harvested from biological assets should be measured at fair value less estimated costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 13 or other sections of this FRS.

Disclosures – cost model

Companies must disclose the following with respect to its biological assets measured using the cost model:

(a) a description of each class of its biological assets.

(b) the depreciation method used.

(c) the useful lives or the depreciation rates used.

(d) a reconiliation of changes in the carrying amount of each class of biological asset to include:

1) Purchases
2) Sales
3) Harvested produce
4) Business Combinations
5) Impairment losses, and
6) Other changes

2. Extractive Industries

Any entity using FRS 102 that is engaged in exploration for, evaluation or extraction of mineral resources should apply IFRS 6 *Exploration for and evaluation of mineral resources*.

3. Service concession arrangements

A service concession arrangement is where a public sector body (the grantor) contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals. The grantor controls or regulates what services the operator must provide using the assets, to whom, and at what price, and also controls any significant residual interest in the assets at the end of the term of the arrangement.

There are two principal categories of service concession arrangements:

(a) The operator receives a **financial asset**— usually an unconditional right to receive cash from the government in return for constructing or upgrading a public sector asset, and then operating and maintaining the asset for a specified period of time. It includes government subsidies for any shortfall between amounts received from users of the public service and specified or determinable amounts.

(b) The operator receives an **intangible asset**—a right to charge for use of a public sector asset that it constructs or upgrades and then operates and maintains for a specified period of time. A right to charge users is not an unconditional right to receive cash because the amounts are contingent on the extent to which the public uses the service.

Sometimes, a single contract may contain both types e.g. the motorway between Dublin and Navan/Cavan where the government has given an unconditional guarantee of payment if there is a shortfall in numbers using the toll road i.e. a financial asset and the entity has a right to charge a toll to the public i.e. an intangible asset.

Operator Accounting – financial asset model

The operator recognises a financial asset to the extent it has an unconditional contractual right to receive cash for the construction services. The operator must measure the financial asset at fair value. Thereafter, it has to follow Sections 11 and 12 (see Chapter 8) in accounting for that financial asset.

Operator Accounting – intangible asset model

The operator recognises an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. The operator must initially measure the intangible asset at fair value and thereafter, follow Section 18 (see Chapter 3) in accounting for that intangible asset.

Operator - Operating revenue

The operator of a service concession arrangement must recognise, measure and disclose revenue in accordance with Section 23 (see Chapter 5) for the services it performs.

Grantor Accounting

The infrastructure assets are recognised as assets of the grantor together with a liability for its obligations under the service concession arrangement. The grantor initially recognises the infrastructure assets and associated liability in accordance with Section 20 Leases (see Chapter 3). The liability is recognised as a finance lease liability and subsequently accounted for in accordance with Section 20. The infrastructure assets are recorded as property, plant and equipment, or as intangible assets as appropriate, and subsequently accounted for in accordance with Section 17 *Property, Plant and Equipment* or Section 18 *Intangible Assets* other than Goodwill (see Chapter 3).

Where the grantor is required, or has an option, to purchase any residual interest in the infrastructure assets at a value other than fair value at the end of the concession period, the difference between the expected fair value attributable to the residual interest at the end of the concession period and the amount to be paid should be recognised on a systematic basis over the life of the arrangement.

4. Financial Institutions: Disclosures

This is a unique section in the FRS as there is no corresponding section in the IFRSSME and this is because financial institutions that are not listed will be allowed to apply FRS 102. In order to protect the investor and the public it is, however, important to insist on greater disclosure by these institutions.

A financial institution, therefore, that applies this FRS, in addition to complying with the Section 11 and 12 (see Chapter 8) disclosures must also apply this section.

A financial institution is defined as either:

- **(a)** a bank; or
- **(b)** a building society; or
- **(c)** a credit union; or
- **(d)** a custodian bank, broker-dealer or stockbroker
- **(e)** an entity that carries out insurance contracts, including general and life assurance; or
- **(f)** an incorporated friendly society or a registered friendly society; or
- **(g)** an investment trust, Irish Investment Company, venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC); or
- **(h)** a retirement benefit plan.
- **(i)** any other entity whose principal activity is to generate wealth through financial instruments.

Significance of financial instruments for financial position and performance

To meet the needs of users a financial institution must therefore disclose information that enables those users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

Entities must disclose a disaggregation of the statement of financial position line item by class of financial instrument.

In addition the following must be disclosed:

Impairment

Where a separate allowance account is used to record impairment, it must disclose a reconciliation of changes in that account during the period for each class of financial assets.

Fair Value

An analysis of financial instruments held at fair value on the statement of financial position must be disclosed using the three level hierarchy in Section 11.

Nature and extent of risks arising from financial instruments

Information that enables users to evaluate the nature and extent of credit, liquidity and market risks arising from financial instruments to which the financial institution is exposed at the end of the reporting period.

For each type of risk arising from financial instruments, a financial institution must disclose:

- **(a)** the exposures to risk and how they arise;
- **(b)** its objectives, policies and processes for managing these risks and the methods adopted to measure the risk; and
- **(c)** any changes in (a) or (b) from the previous period.

Credit risk

A financial institution must disclose by class of financial instrument:

- **(a)** the amount that best represents its **maximum exposure to credit risk** at the end of the reporting period. This disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk;
- **(b)** a description of collateral held as security and the extent to which these mitigate credit risk;
- **(c)** the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk; and
- **(d)** information about the credit quality of financial assets that are neither past due nor impaired.

A maturity analysis, by class of financial assets, that are:

- **(a)** past due as at the end of the reporting period but not impaired; and
- **(b)** individually determined to be impaired as at the end of the reporting period, including the factors the financial institution considered in determining that they are impaired.

When the financial institution obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (e.g. guarantees), and such assets meet the recognition criteria in other sections, it must disclose:

- **(a)** the nature and carrying amount of the assets obtained; and
- **(b)** when the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

Liquidity risk

A maturity analysis for financial liabilities showing the remaining contractual maturities at undiscounted amounts separated between derivative and non-derivative financial liabilities.

Market risk

A sensitivity analysis for each type of market risk (e.g. interest rate risk, currency risk, other price risk) a financial institution is exposed to, showing the impact on profit and loss and equity. Details of the methods and assumptions used should be provided.

If the financial institution prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (e.g. interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis instead.

Capital

Qualitative information about an entity's objectives, policies and processes for managing capital should be disclosed as well as summary quantative data.

Reporting Cash Flows on a Net Basis

A financial institution reporting under Section 7 may report cash flow arising from the following activities on a net basis:

(a) Cash receipts and payments for deposits on a fixed maturity date

(b) Placement of deposits with, and withdrawal of deposits from, other financial institutions; and

(c) Cash advances/loans to customers and their repayment

5. Retirement Benefit Plans: Financial Statements

A retirement benefit plan (RPB) may be a defined benefit (DB) plan, a defined contribution (DC) plan, or have elements of both. The financial statements must distinguish between the two, where material.

Requirements applicable to both DB and DC plans

The financial statements of an RPB must contain the following:

(a) a statement of changes in net assets available for benefits (or Fund Account)

(b) a statement of net assets available for benefits; and

(c) notes - including a summary of significant accounting policies.

At each reporting date, the net assets available for benefits should be measured at fair value with any changes being recognised in the statements of changes in net assets available for benefits.

Statement of changes in net assets available for benefits (Fund Account)

The financial statements of an RPB, whether DC or DB, must present the following in the statement of changes in net assets available for benefits:

(a) employer contributions;

(b) employee contributions;

(c) investment income such as interest and dividends;

(d) other income;

(e) benefits paid or payable analysed by type;

(f) administrative expenses;

(g) other expenses;

(h) taxes on income;

(i) profits and losses on disposal of investments and changes in their value; and

(j) transfers from and to other plans.

Statement of net assets available for benefits

Both DB and DC schemes must present the following in the statement of net assets available for benefits:

(a) assets at the end of the period suitably classified; and

(b) liabilities other than the actuarial present value of promised retirement benefits.

The basis of valuation of assets should also be presented in the note.

Disclosures

Assets other than financial instruments held at fair value

Must apply the disclosure requirements of the relevant section of this FRS e.g. investment property and provide the disclosures required by Section 16.

Significance of financial instruments for financial position and performance. An RPB should disclose information that enables users to evaluate the significance of financial instruments for its financial position and performance. An RPB, therefore, must disclose a disaggregation of the statement of net assets available for benefits by class of financial instrument.

Fair value

For financial instruments held at fair value an RPB must disclose for each class of financial instrument, an analysis of the level in the fair value hierarchy into which they are categorised.

Nature and extent of risks arising from financial instruments

RPBs must disclose sufficient information to enable users to evaluate the nature and extent of credit risk and market risk arising from financial instruments to which the retirement benefit plan is exposed at the end of the reporting period.

For each type of risk arising an RPB must disclose:

(a) the exposures to risk and how they arise;

(b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and

(c) any changes in (a) or (b) from the previous period.

In relation to credit risk, an RPB must also provide the following, by class:

(a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period unless its carrying amount already represents the maximum exposure to credit risk.

(b) A description of collateral held as security and the extent it mitigates credit risk.

(c) he amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

(d) Information about the credit quality of financial assets that are neither past due nor impaired.

When an RPB obtains financial or non-financial assets during the period by taking possession of collateral it holds as security and such assets meet the recognition criteria in other sections, an RPB must disclose:

(a) the nature and carrying amount of the assets obtained; and

(b) when the assets are not readily convertible into cash, its policies for disposing of such assets or for retaining them.

Defined benefit plans – actuarial liabilities

A DB plan is not required to recognise a liability for its promised retirement benefits.

Instead it must disclose, in a separate report alongside its financial statements, information regarding the actuarial present value of promised retirement benefits including:

(a) a statement of the actuarial present value of promised retirement benefits, based on the most recent valuation of the scheme;

(b) the date of the most recent valuation of the scheme; and

(c) the significant actuarial assumptions made and the method used to calculate the actuarial present value of promised retirement benefits.

6. Heritage Assets

All heritage assets are accounted as per this section. Works of art and similar objects are sometimes held by commercial entities but are not heritage assets because they are not maintained principally for their contribution to knowledge and culture. These assets shall therefore be accounted for in accordance with Section 17 (see chapter 3).

Historic assets used by the entity itself, for example historical buildings used for teaching by education establishments, are also accounted for in accordance with Section 17. They are argued to be operational assets.

Recognition and measurement

Heritage assets must be recognised and measured in accordance with Section 17 (i.e. using either the cost model or revaluation model), subject to the requirements below.

Heritage assets must be recognised in the statement of financial position separately from other assets.

Where heritage assets have previously been capitalised or have been recently purchased, information on their cost or value of the asset will be available. However, where this information is not available or too expensive (cost/benefit), the assets are not recognised in the statement of financial position, but must be disclosed as per the requirements below.

At each reporting date, reporting entities should apply Section 27 (see Chapter 3) to determine whether a heritage asset is impaired and, if so, how to recognise and measure any impairment loss.

Disclosure

The following must be disclosed for all heritage assets:

(a) An indication of the nature and scale of heritage assets held by the entity.

(b) The policy for their acquisition, preservation, management and disposal (including a description of the records maintained for the collection of heritage assets and information on the extent to which access to the assets is permitted).

(c) The accounting policies adopted for heritage assets, including measurement.

(d) For heritage assets not recognised in the statement of financial position, the notes must:

- (i) explain the reasons why;
- (ii) describe the significance and nature of those assets; and
- (iii) disclose information that is helpful in assessing their value.

(e) Where heritage assets are recognised in the statement of financial position the following disclosure is required:

(i) their carrying amount at the beginning and end of the reporting period including an analysis between classes or groups of heritage assets at cost and those at valuation; and

(ii) where assets are recognised at valuation, sufficient information to assist in understanding the valuation (date of valuation, method used, external valuer qualification and any significant limitations on the valuation).

(f) A summary of transactions relating to heritage assets for the reporting period and each of the previous four reporting periods disclosing:

(i) the cost of acquisitions of heritage assets;

(ii) the value of heritage assets acquired by donations;

(iii) the carrying amount of heritage assets disposed of in the period and proceeds; and

(iv) any impairment recognised in the period.

The summary shall show separately those transactions included in the statement of financial position and those that are not.

(g) In exceptional circumstances where it is not practicable to obtain a valuation of heritage assets acquired by donation the reason shall be stated.

Disclosures can be aggregated for groups or classes of heritage assets, provided this does not obscure significant information.

The disclosures required by paragraph (f) need not be given for any accounting period earlier than the period immediately before the period in which the FRS is first applied where it is not practicable to do so and a statement to the effect that it is not practicable is made.

7. Funding commitments

An entity that commits to provide resources to other entities must apply the requirements below and the accompanying guidance. Section 2 *Concepts and pervasive principles* and Section 21 *Provisions and contingencies* must also be taken into consideration.

Recognition

A liability is recognised by an entity where it has made a commitment that it will provide resources to another party, but only if:

(a) the definition and recognition criteria for a liability have been met

(b) the obligation cannot realistically be withdrawn; and

(c) the entitlement of the other party to the resources does not depend on the satisfaction of performance conditions.

Commitments made which are performance-related will be recognised when those performance conditions are met.

Measurement

Any recognised liability is measured at the present value of the resources committed.

Disclosure

This includes details of the commitment made, the time-frame of that commitment, any performance-related conditions, and details of how that commitment will be funded.

The disclosures may be made in aggregate, providing it does not obscure significant information.

Summary

This part of the FRS is a "catch all" section to cover more specialised topics and topics that are not adequately covered under international reporting. The agriculture section is new to the UK and Ireland as there has been no local standard to date and could result in an increase for those farming entities to opt for fair value reporting to a greater extent than at present.

There is nothing of note for the extractive industries as it clearly makes reference to the existing IFRS and does not introduce any additional requirements. That may change once a more detailed standard emerges from the IASB. There is currently a project on going for that industry.

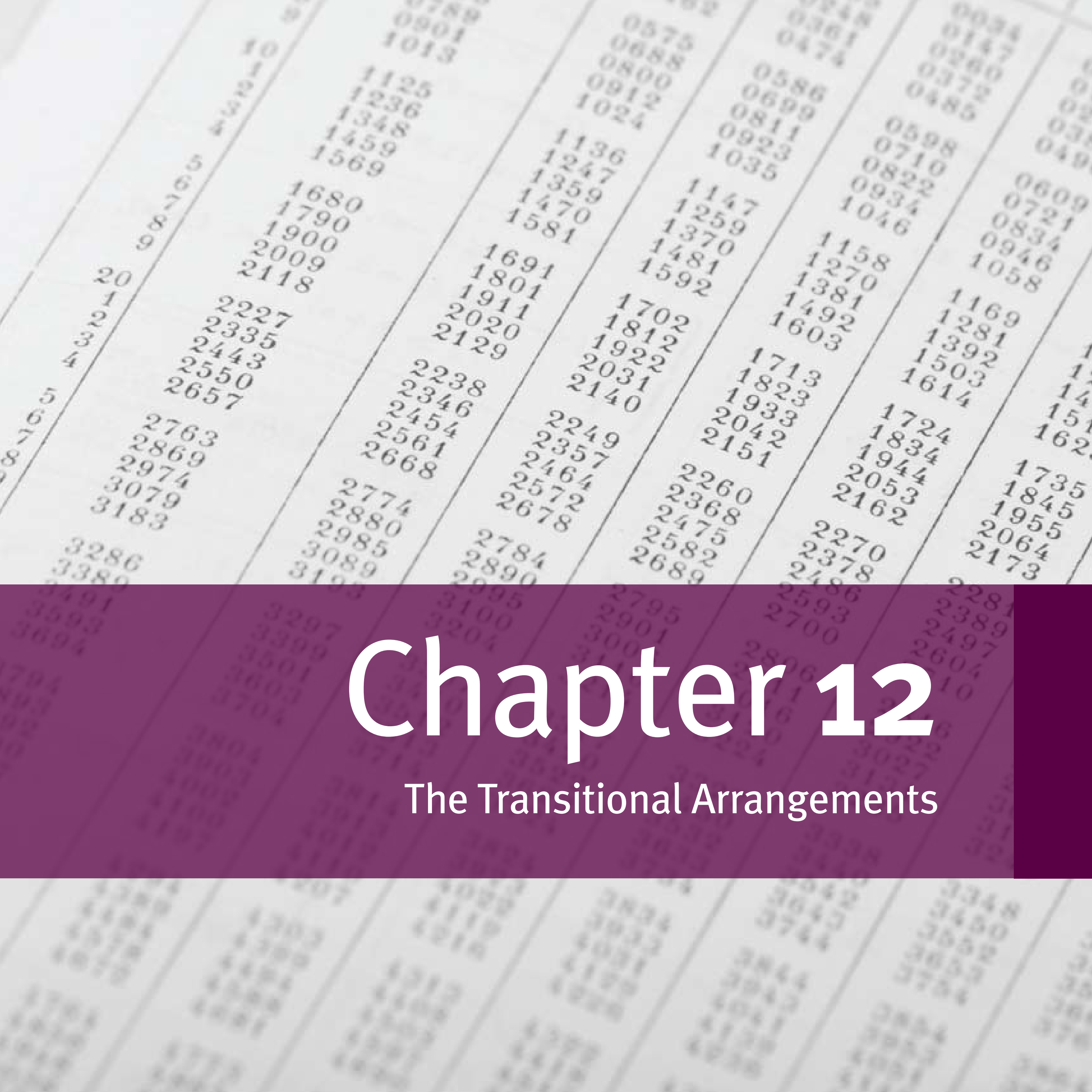
Service concessions are really the same as PFI or PPP contracts in the UK and Ireland. However, it will have an impact as private consortiums will not be able to put the infrastructure that they are developing for the public sector on to their balance sheets. These assets must be recorded on the grantor's books and instead the private sector (operators) should record either a financial or intangible asset or even both on their balance sheets.

As the financial institutions are now permitted to adopt FRS 102, unless listed, it is only right that users be protected by insisting on increased disclosure for those entities particularly on risks and how they are mitigated.

In the original proposals retirement benefit plans were declared to be publicly accountable and therefore would have to apply EU-adopted IFRS. However, having decided to remove the definition of publicly accountable, the ASB reconsidered the subject. One solution would have been to implement a précised version of IAS 26 *Accounting & Reporting by Retirement Benefit Plans* and request that the SORP *Financial Reports of Pensions Schemes,* be updated to be consistent with IAS 26. This option was rejected because of legal difficulties with EU law compliance so following this feedback the ASB decided to develop, as part of the specialised activities section, accounting requirements for retirement benefit plans that could be supplemented by the SORP. FRS 102 therefore sets out the requirements for the financial statements of retirement benefit plans. The FRS requires a statement of financial position excluding the liability to pay pension benefits to be published. However, disclosure of the liability to pay pension benefits is also required.

The ASB spent considerable time and effort in designing a specific UK/Irish standard on how to account and disclose information on heritage assets (FRS 30 *Heritage assets*). The IASB has no requirements to date and so FRS 102 now includes a section specifically on the topic. As most of these were acquired a number of years ago it would be expected that, on cost benefit grounds few will appear on the balance sheet but it still contains extensive disclosures.

Funding commitments were discussed in a past exposure draft specifically geared to public benefit entities but it is now covered in Section 34 and applicable to all reporting entities. However, it is likely to have minimal impact in practice.



Chapter 12

The Transitional Arrangements

Section 35

The Transitional Arrangements

There are obviously problems in switching from the current UK/Irish accounting standards to the new FRS as the rules are different. For example merger accounting is banned in FRS 102 but was permitted in certain circumstances by FRS 6 *Acquisitions and Mergers*. There is therefore the need for a Section in the new standard to guide preparers through the transitional phase. This is contained in Section 35 of the document.

This section applies to a first time adopter of the FRS regardless of whether they have been previously using UK/Irish standards or full IFRSs. This section also can only be applied in the first financial statements conforming to the FRS.

An entity's first financial statements that conform with the FRS are the first annual statements in which the entity makes an explicit and unreserved statement of compliance with the FRS. These are the first statements if:

- the reporting entity did not present financial statements in previous periods; or
- the entity presented its most recent previous financial statements under FRSs and SSAPs; or
- the entity presented its most recent previous financial statements in conformity with full IFRSs.

The FRS requires a complete set of financial statements to disclose comparatives for the previous comparable period for all monetary amounts reported in the statements as well as specified narrative and descriptive information. Comparatives may be presented for more than one prior period. The key date is the date of transition i.e. the start of the earliest period for which the entity presents full comparative information in accordance with FRS 102.

Procedures for preparing financial statements at the date of transition

Except as provided below, all reporting entities must, in their opening statement of financial position at the date of transition:

- recognise all assets and liabilities required by the FRS
- not recognise assets or liabilities if the FRS does not permit such recognition
- reclassify items recognised previously as one type of asset, liability, equity etc but are recognised as different types under the FRS; and
- apply the FRS in measuring all recognised assets and liabilities

The accounting policies adopted in the opening statement of financial position may differ from previous SSAPs and FRSs and therefore any adjustments must be recognised directly in retained earnings at the date of transition to the FRS.

However, on first time adoption of the FRS, the following are not permitted to be changed on transition and must continue to be accounted for under previous FRSs or SSAPs:

- derecognition of financial assets and liabilities
- hedge accounting
- accounting estimates
- discontinued operations
- measuring non-controlling interests

Possible exemptions

Reporting entities **may** avail of one or more of the following exemptions in preparing its first statements under the FRS:

Business combinations – may elect not to adopt Section 19 for past combinations but if they do restate any previous combination they must restate all later combinations i.e. if treated as a merger previously they do not need to adjust.

Share based payment transactions – encouraged but not required to apply Section 26 to equity granted schemes before the date of transition or to liabilities settled before the date of transition.

Fair value as deemed cost – may adopt the previous revaluation under the FRSs/SSAPs as the deemed cost of an asset under the FRS.

Revaluation as deemed cost – may use previous revaluation under the FRSs/SSAPs as the deemed cost at the date of revaluation.

Individual and separate financial statements – must measure investment in subsidiaries, associates and jointly controlled entities either at cost or at fair value.

Compound financial instruments – need not separate its two components into debt/equity if the debt component is not outstanding at the date of transition.

Service concession arrangements (by operators) - not required to apply Section 34 to service concession arrangements entered into before the date of transition to this FRS.

Extractive activities - if adopting full cost accounting under FRSs/SSAPs may elect to measure oil and gas assets on the date of transition at the amount determined under the FRSs/SSAPs. However, those assets must be tested for impairment at the date of transition to the FRS in accordance with Section 27.

Arrangements containing a lease - may elect to determine whether an arrangement existing at the date of transition contains a lease on the basis of facts and circumstances existing at that date, rather than when the arrangement was entered into.

Decommissioning liabilities included in the cost of property, plant and equipment - Section 17 states that the cost of an item of property etc includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. The entity may elect to measure this component of the cost of an item of property at the date of transition, rather than on the date(s) when the obligation initially arose.

Dormant companies - may elect to retain its accounting policies for measurement of reported assets, liabilities and equity at the date of transition to this FRS until there is any change to those balances or the company undertakes any new transactions.

Deferred development costs – treat as a deemed cost. A first-time adopter may elect to measure the carrying amount at the date of transition to this FRS for development costs deferred in accordance with SSAP 13 *Research and development* as its deemed cost at that date.

Borrowing costs - an entity electing to adopt an accounting policy of capitalising borrowing costs as part of the cost of a qualifying asset may elect to treat the date of transition to this FRS as the date on which capitalisation commences.

Lease Incentives – do not need to apply Section 20 provided the term of the lease commenced before the date of transition to the FRS. There are also additional exemptions for subsidiaries that adopt the FRS later than their parent and to designate previously recognised financial instruments at fair value through profit and loss.

Public benefit entity combinations - a first time adopter may elect not to apply Section 34 relating to PBE combinations that were effected before the date of transition to this FRS. However, if on first- time adoption a PBE restates any entity combination to comply with this section, it must restate all later entity combinations.

If it is impracticable to restate the opening statement of financial position at the date of transition for one or more of the adjustments a reporting entity must apply those adjustments to the earliest period for which it is practicable to do so, and identify the data presented for prior periods that are not comparable with the data for the period in which it prepares its first financial statements that conform to this FRS.

If it is impracticable for an entity to provide any disclosures required by this FRS for any period before the period in which it prepares its first financial statements that conform to this FRS, the omission shall be disclosed.

Disclosures

An entity needs to explain how the transition from FRSs/SSAPs to the new FRS has affected the financial position, performance and cash flows of the reporting entity.

Reconciliations

As part of that process the first financial statements must include:

- a description of the nature of each change in accounting policy
- reconciliation of its equity reported under FRSs/SSAPs to equity under the FRS for both:
  - the date of transition; and
  - the end of the latest period presented in the entity's most recent annual financial statements under previous SSAPs/FRSs; and
- a reconciliation of profit or loss reported under previous SSAPs/FRSs for the latest period to the profit or loss under the new FRS for the same period

If an entity becomes aware of errors made under previous standards the reconciliations must distinguish those errors from any changes made in accounting policy.

If the entity did not previously present financial statements it shall disclose that fact in its first FRS financial statements.

Summary

The real work and costs incurred by reporting entities will be in switching from current local standards to the new FRS 102 and this will undoubtedly take place during the year of transition. For years ending 31st December 2015 (first full year under FRS 102) the date of transition is the 1st January 2014 and a reconciliation of equity will be required at that date as well as at the 31st December 2014 and a reconciliation of profit between the two systems will be required for the year ended 31st December 2014.

However, once the year of transition has been completed financial reporting should be relatively simplified in the future.

Appendix

FRS 101

Appendix

FRS 101

Reduced Disclosure Framework (November 2012)

Summary

FRS 101 should result in cost savings in the preparation of financial statements of subsidiaries and ultimate parents, without reducing the quality of financial reporting.

Disclosure exemptions are available to a **qualifying entity**, as defined in FRS 100, in its individual accounts (but not in any consolidated financial statements which it is required or voluntarily chooses to prepare).

FRS 101

Objective

The objective of FRS 101 is to set out the financial reporting requirements and disclosure exemptions (a reduced disclosure framework) for the financial statements of subsidiaries and ultimate parents that otherwise apply the recognition, measurement and disclosure requirements of standards and interpretations issued by the IASB as adopted in the EU.

Scope

FRS 101 applies to the financial statements of a qualifying entity, as defined in FRS 100, that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period.

Reduced disclosures for subsidiaries and ultimate parents

A qualifying entity which **is not a financial institution** may take advantage in its individual accounts of the disclosure exemptions set out in paragraphs 8-9 of FRS 101. Where a qualifying entity has financial liabilities held at fair value which are neither held as part of a trading portfolio nor are derivatives, however, it must apply the disclosure requirements of paragraphs 8(e), 10, 11, 17, 20(a)(i), 25, 26, 27, 27A, 28, 29, 30 of IFRS 7 to those financial liabilities.

A qualifying entity which **is a financial institution** may take advantage in its individual accounts of the disclosure exemptions set out in paragraphs 8-9 of FRS 101, other than the disclosure exemptions from IFRS 7 and IFRS 13.

However, a qualifying entity which is required to prepare consolidated financial statements (e.g. S151 of 1963 Act and Reg 5 of the European Communities (Group Account) Regulations (S.I. 201 of 1992) to prepare group accounts, and is not entitled to any of the exemptions in Reg 7-9 of the European Communities (Group Account) Regulations (S.I. 201 of 1992))., or which voluntarily chooses to do so, may **not apply** this FRS in its consolidated financial statements.

A qualifying entity may take advantage of the disclosure exemptions in paragraphs 8-9 of this FRS, in accordance with paragraphs 4-6 of this FRS, only if:

(a) its shareholders have been notified in writing about, and do not object to, the use of the disclosure exemptions. A shareholder may object to the use of the disclosure exemptions only if the shareholder is the immediate parent of the entity, or if the shareholder holds more than half of the allotted shares in the entity that are not held by the immediate parent, or if the shareholder holds 5% or more of the total allotted shares in the entity;

(b) it otherwise applies the recognition, measurement and disclosure requirements of EU adopted IFRS, but makes amendments to EU-adopted IFRS requirements where necessary in order to comply with the Act and the Regulations, so that the financial statements that it prepares are Companies Act individual accounts as defined in the format laid down by the Companies Acts 1963 – 2012 ("Companies Acts individual accounts") and not in accordance with international accounting standards ("IAS individual accounts"); and

(c) it states in the notes to its financial statements:

  (i) the relevant standard and paragraph references of the exemptions adopted; and

(ii) the name of the parent in whose consolidated financial statements its financial statements are consolidated, and from where those financial statements may be obtained.

The Disclosure Exemptions (Para 8)

A qualifying entity may take advantage of the following disclosure exemptions, from when the relevant standard is applied:

(a) the requirements of paragraphs 45(b) and 46-52 of **IFRS 2**, except for a group arrangement involving equity instruments of an entity other than the parent, providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;

(b) the requirements of paragraphs B64(d), B64(e), B64(g), B64(h), B64(j)-B64(m), B64(n)(ii), B64(o)(ii), B64(p), B64(q), B66 and B67 of **IFRS 3** (for the acquisition of a group of assets that constitute a business), providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;

(c) the requirements of paragraph 33(b) and 33(c) of **IFRS 5**, providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;

(d) the requirements of **IFRS 7** providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;

(e) the requirements of paragraphs 91-99 of **IFRS 13**, providing equivalent disclosures are included in the consolidated financial statements of the group in which the entity is consolidated;

(f) the requirement in paragraph 38 of **IAS 1** to present **comparative** information in respect of:

(i) paragraph 73(e) of **IAS 16**; and

(ii) paragraph 118(e) of **IAS 38**; and

(iii) paragraph 76 and 79(d) of **IAS 40**;

(g) the requirements of paragraphs 10(d), 10(f), 39(c) and 134-136 of **IAS 1**; in addition, the reference to **IAS 1** in paragraph 21 of **IFRS 1** may be ignored;

(h) the requirements of **IAS 7**;

(i) the requirements of paragraphs 30 and 31 of **IAS 8**;

(j) the requirements of paragraph 74(c) of **IAS 16**;

(k the requirements of paragraph 17 of **IAS 24**;

(l) the requirements in **IAS 24** to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by a member of that group;

(m) the requirements of paragraphs 134(d)-134(f) and 135(c)-135(e) of **IAS 36**, providing equivalent disclosures are included in the consolidated financial statements of the parent in which the entity is consolidated; and

(n) the requirements of paragraph 122(e) of **IAS 38**.

Reference should be made to the Application Guidance to FRS 100 in deciding whether the consolidated financial statements of the parent provide disclosures which are equivalent to the requirements of EU-adopted IFRS, from which relief is provided in paragraph 8 of this FRS.

Date from which effective and transitional arrangements

An entity may apply this FRS 101 for accounting periods beginning on or after 1 January 2015 but early application is permitted for accounting periods beginning on or after the date of issue of this standard, subject to the additional requirement for a public benefit entity that it must also apply a public benefit entity SORP which has been developed in accordance with the standard, FRS 100 and FRS 102.

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