BY
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Professional Judgement and FRS 102

Maureen Kelly outlines some areas of FRS 102 where accountants must use their own professional judgement, a key difference to the prescriptive Irish GAAP.

Members may have noticed that FRS102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* is not as prescriptive as Irish GAAP used to be in certain areas. In order to reduce the size of the standard there is a greater reliance on the professional judgement of the accountant using it rather than more detailed guidance within the standard itself. This I believe should be welcomed by accountants as it should result in the production of more relevant financial statements.

Section 10 of FRS 102, for example, provides guidance on the treatment of accounting policies, estimates and errors. Whilst these three are defined and their treatment detailed within this section the many examples which were contained within FRS18 are not present here. Instead there is an acknowledgement that, at times, it can be difficult to distinguish a change in accounting policy from a change in an accounting estimate. The guidance in the standard then goes on to state that when this occurs the change is treated as a change in accounting estimate. So the accountant needs to consider all the aspects of the event before making a decision on the most appropriate treatment. It is recommended that the accountant fully documents their decision to support the action they have chosen.

Another area where the amount of guidance has considerably reduced is regarding related party transaction disclosures. This was governed by FRS 8, a standard of 18 pages. It is now in Section 33 and only extends to 3 pages. The previous standard provided detailed guidance on how to apply the standard whereas FRS102 still provides the necessary definitions but relies on the capacity of the Accountant to interpret and apply the standard. We need to consider each possible related party relationship based on substance over legal form. In other words we need to use our professional judgement.

As with current trends in the auditing arena where there is an attempt to move away from "boilerplate" audit reports, in the financial reporting area it is acknowledged that stakeholders want more relevant disclosures in their annual financial statements. That is not to say they want an increase in the volume of disclosures but rather that only relevant disclosures should be made. They don't want boilerplate compliance documents but rather instruments of communication which provide them with the information they need to make educated decisions about the entity.

The Financial Reporting Council (FRC), which is the accounting standard setter for Ireland, says that they aim to provide succinct financial reporting standards. And with this aim in mind where the specific sections within FRS102 do not provide precise guidance on the treatment of a particular transaction the standard directs you to Section 2 Concepts and Pervasive Principles. This is a more grown up attitude to financial reporting standards and the professionals who use them. If we look to the basics of a particular transaction and follow the principles as set out in Section 2 we can normally identify the most appropriate treatment for it. Our qualitative characteristics of information should guide our treatment of disclosures and the general recognition and measurement principles should inform our treatment of the items in the financial statements.

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Section 10 of FRS 102 in its guidance on selection and application of appropriate accounting policies acknowledges the broader knowledge base of most accountants. It refers to the principles in Section 2 but also points to where outside FRS102 one should look for guidance where the standard does not specifically address a transaction. It directs us to consider the guidance in SORPs and IFRSs. This is consistent with the FRCs objective to provide financial reporting standards which ***have consistency with international accounting standards through the application of an IFRS-based solution.*** But at the same time we must consider the overriding principal of TMI (too much information). Presenting the relevant information without excessive disclosures which actually cloud rather than clarify the position is the responsibility of the professional Accountant.

With the increased reliance on the professional judgement of the accountant we now have in Section 8, FRS 102 on the Notes to the Financial Statements a requirement for all entities to disclose those judgements that have been made. Both in the process of applying the entities accounting policies and those that have the most significant effect on the amounts recognised in their financial statements. So although there is a recognition that the professional judgement of the accountant is essential it is not without the requirement for that professional to explain decisions made.

Whilst acknowledging that the skills and experience of the Accountant are vital in the preparation of the financial statements there is also a recognition that there can be uncertainty around some of the figures. We are not expected to be fortune tellers. The standard therefore requires disclosure about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. This once again is recognising that professional judgement is necessary in the preparation of the financial statements whilst ensuring that there is some logical basis for the figures presented.

Professional judgement is something which comes into play when we consider materiality. We can see many mentions throughout FRS102 to material and immaterial items (the definition of Material is set out in Section 2). Our decisions on materiality impact on every area of the financial statements and must be to the forefront of our minds when preparing financial statements. We must decide if an item is material and therefore must be included in the financial statements as to do otherwise "could influence the economic decisions of users taken on the basis of the financial statements." But we also must be conscious of the need not to clutter the financial statements with immaterial information which could impair the capacity of the users to understand them.

Our professional judgement will be particularly relevant at the date of Transition to FRS102. At this point we have been given many accounting choices. Is a lease on the books still a lease? You can decide. What is the real value of our fixed assets? We can choose their current fair value or a previous revaluation as their deemed costs at the date of transition. What is the most appropriate for our assets? Do we account for investments in subsidiaries, associates and jointly controlled entities at cost less impairment or at fair value? Which accounting policy do we wish to choose for grants the new performance model or the old familiar accrual model? Will it suit us to capitalise borrowing costs on qualifying assets from the date of transition? So many choices and we will be the professionals asked to advise business on which is the most appropriate choice for their entity.

There is an ongoing movement towards more relevant financial statements with appropriate disclosures. This can be seen most recently in the pending introduction of Irish GAAP standards for smaller entities which acknowledges the need to tailor the reporting to the size of the entity. The International Standards setters have also stated that their intention is to use less prescriptive wordings for disclosure requirements instead focusing on disclosure objectives.

The move towards less prescriptive accounting standards is a good one for the continued viability of the profession of accountant. More and more you will have noticed that we are at risk from technology as the capacity of accounting software increases each day. But so long as the professional judgement of the accountant is required to make the entity specific decisions which can lead to a more profitable organisation and as long as we can articulate and display the "Value Add" that we provide to our clients or employers we will continue to be an indispensible element to all businesses.