BY
Robert Kirk

Top Ten Hit Parade of FRS 102 Issues

Robert Kirk looks at the 10 most common adjustments companies have had to make under FRS 102.

Robert Kirk CPA is Professor of Financial Reporting at the University of Ulster. Robert is also author of the CPA Ireland Skillnet's publication *A New Era for Irish & UK GAAP – A Quick Reference Guide to FRS 102* which is available free of charge to CPA Members on www.cpaireland.ie.

A number of Irish and UK companies have already submitted their first set of FRS 102 financial statements which had to be applied at the latest to accounts ending 31st December 2015 and onwards.

In this article I have picked out the ten most popular of the adjustments that companies have had to make to reconcile their old Irish GAAP accounts to comply with FRS 102. They are as follows:

1. Implementation of new primary statements

FRS 102 has implemented the same primary statements that are required by full IFRS with one exception – that if a company does not have any transactions or events that could be classified within 'other comprehensive income' it would require only three rather than five primary statements – the Statement of Financial Position, Statement of income and retained earnings and the Statement of cash flows.

However, for those companies that do have 'other comprehensive income' the new primary statements are:

FRS 102	Old Irish GAAP
Statement of Financial Position	Balance Sheet
Income Statement	Profit and loss account
Statement of Comprehensive Income	Statement of total recognised gains and losses
Statement of Cash Flows	Cash Flow Statement
Statement of Changes in equity	Shareholders funds (usually a note only)
No equivalent	Note of historical cost profits and losses

The latest European Directive introduces more flexibility into the layout and headings currently required under the Companies Act 2014 but the legislation has not yet been enacted by the Irish government so the strict formats and headings should still be retained.

Other titles for these documents can be adopted as long as they are not misleading and it is interesting to note that the Musgrave Group are still using the terms Consolidated Profit and Loss Account and Consolidated Balance Sheet, Ornua have adopted the Income Statement but retained the term Balance Sheet. However, Travelodge in the UK, decided to adopt both of the new titles. It is strange that the standard was supposed to bring in more comparability but it is actually resulting in more variety and users will be confused by the different terminology now being adopted in practice for the same documents.

2. Holiday pay accrual for the first time

Although a large number of companies had accrued in the past for holiday pay it is clearly now mandatory to include it in the financial statements, particularly if it is a material amount. That would generally be the case where the accounting year end does not coincide with the holiday year end. In my college with a year end of 31st July 2015 and holiday year end of 31st December 2015 we have had to accrue for 7/12yr holidays for staff who have not taken any holidays up to that date but at the same time create a prepayment for staff who perhaps have taken say 9 months of their leave in the first seven months and hence owe the college two months holidays!

The Irish Rugby Football Union (IRFU) had only two transitional adjustments to comply with FRS 102 but one of these was the holiday accrual which added €748,232 to their original 30th April 2015 total expenditure for the year (i.e. increased from €60,626,444 to €61,374,676).

3. Derivatives being recorded on the balance sheet for the first time

Many Irish companies have adopted the use of derivatives such as forward foreign currency contracts to reduce their overall exposure to foreign currency movements and under old Irish GAAP purchases and sales would have all been recorded at those forward rates as well as creditors and debtors respectively. Under FRS 102, however, they must now be recorded at their spot rate at the year-end resulting in exchange differences being reported in profit for the first time as well as derivatives being reported on the balance sheet at fair value.

The following is an extract from Ornua's financial statements on transition to FRS 102:

Recognition of Derivative Financial Instruments

FRS 102 requires derivative financial instruments to be recognised at fair value on its Balance Sheet. Previous GAAP did not recognise these instruments in the financial statements. On transition to FRS 102 the Group has adopted cash flow hedging to manage its exposure to foreign currency exchange risk arising on the Group's sales in foreign currencies. Accordingly at transition an asset of €0.4m (net of tax) was recognised. A loss of €2.4m (net of tax) was recognised in the Income Statement for the period ended 27 December 2014.

Ornua Annual Report

As you can see from the FRS 102 reconciliation of profit statement it was the largest adjustment to their original Irish GAAP financial statements for the year ended 31st December 2014:

Reconciliation of profit	**2014 €'000**
Profit after taxation for the period (as previously stated under Irish GAAP)	21,601
Adjustments: (net of tax where relevant)	
Holiday pay accrual	(15)
Defined benefit pension scheme	(1,181)
Reverse discounting of deferred tax	742
Recognition of derivative financial instruments	(2,355)
Profit after taxation for the year as restated under FRS 102	18,792

Ornua Annual Report

4. Deferred tax being increased for all property revaluations including investment properties

Under FRS 102 deferred tax must now be provided on all revaluations of property. Previously the argument would have been that there was no need to provide deferred tax as there was no intention to sell those properties. Assuming property values have risen then the credit would go to deferred tax liability but the debit entry will either be reported in retained earnings (for investment properties) or in revaluation reserves (if ordinary properties).

The Musgrave Group had to adjust their Irish GAAP accounts on transition as follows:

Deferred taxation on the revaluation reserve

On transition to FRS 102, the Group recognised a deferred taxation liability of €8.5 million on the revaluation reserve for land and buildings at the transition date, as required by FRS 102. This was unchanged at 31 December 2013.

Deferred taxation on revaluation reserve	ii)	(8.5)	(8.5)

Musgrave Group Annual Report

As can be seen above it resulted in an increase in their tax liability of €8.5m on transition.

5. Re-measurement of defined benefit obligations

Under old Irish GAAP entities recognised an expected return on defined benefit plan assets in the Profit and Loss Account. The difference between expected returns on plan assets and the actual return was recognised in the Statement of Total Recognised Gains and Losses as part of the actuarial gain or loss on defined benefit pensions. Under FRS 102 a net interest expense, based on the net defined benefit liability, is recognised in the Income Statement. The difference between the net interest expense and the actual return on plan assets is recognised in Other Comprehensive Income as part of the re-measurement of the net defined benefit liability.

That was the second of the two adjustments that the IRFU had to make to switch over to FRS 102 as can be seen in their reconciliation of equity statement:

Consolidated	**As previously Stated at 30 April 2015 €**	**Effect of transition €**	**FRS 102 as restated 30 April 2015 €**
Income	72,380,381	–	72,380,381
Expenditure	(60,626,444)	(748,232)	11,005,705
Surplus for the year	11,753,937	(748,232)	11,005,705
Actuarial movement on pension	(1,548,000)	144,000	1,404,000)
Total surplus for the year	**10,205,937**	**(604,232)**	**9,601,705**

IRFU Annual Report

6. One off revaluation of property at the date of transition

As part of the optional provisions in Section 35 of FRS 102 companies can avail of the opportunity to carry out a once off valuation of their property even if they have never revalued previously. They can then adopt that valuation as their deemed cost henceforth. Similarly companies that are currently revaluing under old Irish GAAP can elect not to continue to revalue but adopt their last valuation as their deemed cost going forward.

▶ Continued on Page 14

Continued from Page 13

My own college has already availed of the first option to revalue its properties at our date of transition which was the 1st August 2015 and Travelodge have opted for the second option as can be seen below:

Transition to FRS102 – Income Statement

FRS102 has been early adopted by the Company at 31 December 2012. The date of transition is 1 January 2011. The result of this adoption can be seen below:

Fixed Assets

Under UK GAAP, the Company previously adopted a policy of revaluing tangible fixed assets.

Under FRS 102, the Company has elected to adopt a 'deemed cost' value at the date of transition. This reflects the value of the tangible assets under the previous revaluation policy under UK GAAP at the date of transition (1 January 2011). The Company will no longer apply the revaluation model under FRS 102 and will hold assets at the deemed cost and depreciated them over their useful economic lives. Revaluations will no longer be performed.

Travelodge Annual Report

Of course that also has an impact on deferred tax as a liability will have to be created for the potential capital gains tax due if those properties were eventually to be sold.

Transition to Frs102 - Reserves

Reconciliation of capital and reserves	As at 1 January 2011 £m	As at 31 December 2011 £m
Capital and reserves (as previously stated)	888.4	741.3
Deferred tax movement on revaluation reserve[1]	(94.8)	(53.8)
Rent free reverse premium on leased properties[2]	-	(1.0)
Prior year adjustment[3]	5.0	5.0
Capital and Reserves (as restated)	**798.6**	**691.5**

Travelodge Annual Report

Travelodge, even after adopting a deemed cost approach did have to create a deferred tax liability of £94.8m on its revaluations up to their date of transition.

7. Financial assets being recorded at fair value for the first time

FRS 102 introduces the concept of fair value reporting to complex financial instruments in Section 12 of the standard. Unfortunately it does include investments made in other companies which previously would have been recorded at cost on the balance sheet.

However, if a fair value cannot be reliably measured then the accounting treatment reverts back to cost. The Welsh Rugby Union (WRU) have reported that in their accounting policies note as follows:

Financial instruments (Extract)

The Group has chosen to adopt Sections 11 and 12 of FRS102 in respect of financial instruments.

Financial assets

Other financial assets, including investments in equity instruments which are not subsidiaries, associates or joint ventures, are initially measured at fair value, which is normally the transaction price. Such assets are subsequently carried at fair value and the changes in fair value are recognised in the Income Statement, except that investments in equity instruments that are not publicly traded and whose fair values cannot be measured reliably are measured at cost less impairment.

WRU Annual Report

8. Reversal of discounting of deferred tax

In addition to increasing the deferred tax charge for revaluations of property another issue arises for those entities that had previously discounted their deferred tax balances under old Irish GAAP. That is not permitted by FRS 102 and, on transition, Ornua had to reverse their discounting. As you can see from the example in 3) above it resulted in an increase of €742,000 in deferred tax.

9. Reclassification of investment property reserves to revaluation reserves

Under FRS 102 companies are no longer permitted to record their revaluation surpluses and deficits on investment properties in a separate investment property revaluation reserve and also within the statement of recognised gains and losses as a recognised gain or loss. Instead, under FRS 102, all gains and losses must be reported directly in profit and loss despite the fact that the properties have not been sold. On transition that results in a requirement to reclassify the investment property reserve to retained earnings. Because that has no impact on overall equity it would not be shown as a reconciliation entry on transition.

The Musgrave Group had this issue:

Tangible assets revaluation

On transition to FRS 102, the Group has elected to use the previous valuation of certain land and buildings at 31 December 2012 as the deemed cost for those assets and to discontinue its policy of revaluing land and buildings. There is no effect on the balance sheet on the transition date of 1 January 2013. The revaluation loss of €5.8 million previously booked in 2013 was reversed along with €0.1 million of other adjustments, and this was offset by a €2.9 million charge to the profit and loss account for additional impairments required, resulting in a net €3.0 million increase in tangible assets and equity as at 31 December 2013.

Under FRS 102, movements in the value of investment properties are taken to the profit and loss account rather than the revaluation reserve. A €0.8 million revaluation loss arose in 2013 and combined with the €2.9 million adjustment above, this resulted in €3.7 million total charge to the profit and loss account in 2013.

Musgrave Group Annual Report

Continued on Page 16

relate software

800+ Practices have switched

1 CLICK iXBRL ALSO INCLUDED

FIRST FOR COMPLIANCE, FIRST FOR SERVICE

KEY FEATURES

- Fully FRS 102 Compliant
- Full Charities SORP 2015 Format
- Full SAGE and CCH Import Routines
- Auto Updated Compliance
- No Formatting Required
- Dedicated Support Team Based in Ireland
- 1 Click iXBRL Solution
- Includes ROI, UK & NI Compliance Formats
- Group/Consolidated Accounts
- CAI PQA -Paperless Audit Pack Available
- Full Bookkeeping Module
- Part of the Relate integrated suite.

"It is early days with FRS 102 but as usual Relate are always first with their compliance updates and we are working well with FRS 102 in Relate Accounts Production"

David Jones, Managing Partner PGL Advisory

Free Sample
To receive a free set of FRS 102 accounts
email info@relate-software.com

For an onsite presentation
call us on +353 1 4597800 or email us
on info@relate-software.com

▶ Continued from Page 14

Although Ornua does not have that particular problem it does in the course of its transition note describe a number of other reclassifications that they have had to make to ensure they are FRS 102 compliant.

Other Adjustments

In addition to the transition adjustments identified above which affect profit for the period,the following adjustments have a risen which had no effect on equity or profit but which have affected the presentation of these items in the Income Statement or Balance Sheet:

(a) Computer Software,with a net book value of €9.3m has been reclassified on transition from tangible assets to intangible assets as required under FRS 102. This has no effect on the Group's net assets or profit, except that previous depreciation charge is now described as amortisation and has been reclassified as such in the Income Statement.

(b) Under FRS 102 the deferred tax asset at 29 December 2013 of €3.8m arising on the post employment benefit liability is now included within deferred tax on the Balance Sheet. Under previous GAAP such a deferred tax asset was offset against the post retirement liability on the Balance Sheet.

(c) Under FRS 102 spare parts related to items of tangible assets are carried within tangible assets. Under previous GAAP they were carried within inventory. On transition to FRS 102 an amount of €0.1m in relation to spare parts was transferred from inventory to tangible assets.

(d) Under FRS 102 the Group's Research & Development tax credit should be accounted for within operating profit. Under previous GAAP it was accounted for within taxation.The effect is that for the period to 27 December 2014 a credit of €0.3m is reclassified from taxation to operating profit

(e) Under FRS 102 in general more other intangible assets get recognised on acquisition with less amounts of goodwill being recognised. The Group has taken the option under FRS 102 to apply this provision only to acquisitions that occurred after the date of transition to FRS 102.The effect of this is that an amount of €22.7m was transferred from goodwill to other intangible assets as at 27 December 2014.

(f) Under FRS 102 certain items that were previously carried within creditors are now carried within provisions. The effect is that for the period to 27 December 2014 an amount of €11.9m is reclassified from creditors to provisions.

Ornua Annual Report

10. Reassessment of the depreciable amount of property, plant and equipment

Under old Irish GAAP entities were not able to change their estimate of the residual value of property from their initial estimate on acquisition. Under FRS 102 the residual value must be regularly re-estimated and that can in theory lead to a nil depreciation situation if the residual values are equal to or exceed the original cost of the asset. Even if that is not the case it should probably lead to a reassessment and a reduction in the depreciation charge. That point has been picked up by the Musgrave Group as follows:

Useful economic lives of tangible assets

The annual depreciation charge for tangible assets is sensitive to changes in the estimated useful economic lives and residual values of the assets. The useful economic lives and residual values are re-assessed annually. They are amended when necessary to reflect current estimates, based on future investments, economic utilisation and the physical condition of the assets. See note 12 for the carrying amount of the tangible assets.

Musgrave Group Annual Report

In addition to the above, companies will have to look carefully at their very large assets of property, plant and equipment to ascertain whether or not there is a need to split them up into smaller components and depreciate those separate components over different economic useful lives. However, I have not come across any examples of that issue to date.

Conclusion

It is obviously still early days in the implementation of FRS 102 and there are other areas which could pose problems for those implementing the standard. Some may have to ensure that rebates to customers are deducted from turnover rather than being included in cost of sales and companies will need to be very careful how they deal with inter-company and employee loans to ensure that an effective rate of interest is charged regardless of whether it has been arranged on an interest free basis. In the latter case the key is to have the inter-company loan on demand and if you want to avoid including the loan in current liabilities you might try to ensure the loan is negotiated for one year and one day and therefore could be reported within non-current liabilities. Technically, while this might be acceptable, one might regard this as a little 'too creative'.

Unfortunately all entities when reporting under FRS 102 will have to read the fine print carefully, particularly in Section 35 of the standard, to ensure that they have complied fully with FRS 102.