# FRS 100–102: How Is It for You?

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## Introduction

When the new mandatory accounting framework for Irish and UK companies was issued in March 2013, the transition date seemed a long way off. Indeed it was, but now the effective date for most companies, 1 January 2015, has come and gone, and the question arises: how is it for you?

There is not a one-size-fits all answer to that question. A minority of companies have applied the new framework early so as to take the benefit of the reduced disclosure framework; the vast majority have yet to start any work on the conversion; and there are the lucky few that, by not having a calendar year-end, get another year of grace and so can see how it has impacted on others before making their own decisions on next steps.

In this context, let us remind ourselves of the changes in the accounting framework before considering some of the potential business, as well as accounting, impacts. Figure 1 provides a snapshot of those changes.

### Figure 1: Snapshot of the new framework

- FRS 100 sets out the new reporting framework, essentially outlining potential choices for companies.
- FRS 101 introduces a reduced disclosure framework for "qualifying entities". This represents an opportunity to make the statutory accounting process more efficient.
- FRS 102, although largely based on the International Accounting Standards Board's IFRS for SMEs, has been amended for company law and other matters. This now replaces all SSAPs, FRSs and UITF Abstracts.
- FRS 103 consolidates the guidance in IFRS 4, FRS 27 and the Association of British Insurers' SORP. It applies only to insurance companies that select FRS 102 as their basis of accounting.
- The FRSSE continues to be available for non-complex business, but it has not historically been popular in Ireland, particularly with those that have banking facilities.
- Application of the new framework is mandatory for accounting periods beginning on or after 1 January 2015.

The choice in FRS 100 means that the numbers in the financial statements can be prepared on the basis of IFRS, FRS 102 or the FRSSE (Financial Reporting Standard for Smaller Entities). The framework that you choose should be influenced by the complexity of your business and the stakeholder group involved. For example, if your business is operated through a single company and undertakes trade in Ireland only, it is likely that the directors will choose to apply either FRS 102 or the FRSSE. If so, then for the most part the new accounting framework will impact on the look and feel of the financial statements, but the reported numbers may not change significantly. For businesses that are more complex, that involve trading through a group or that are just bigger in size, there is likely to be an impact not only in the numbers and disclosures reported but also potentially on other areas of the business such as tax or IT.

## Conversion Adjustments to Date

The list below is not intended to be exhaustive, but a number of themes have recurred during the conversion projects we have undertaken and the planning conversations we have held with clients.

### Revenue

This is not an area where many people would expect a difference, but for many this is the largest number in the financial statements, and for that reason alone it needs a close review. In a number of cases we have found differences arising because the actual accounting procedure applied in determining revenue is different from the macro accounting policy included in the statutory financial statements. The application of the percentage-of-completion method and the differentiation between types of licence revenue have resulted in adjustments for some companies.

### Holiday pay

The guidance in both IFRS and FRS 102 covers the full extent of employee benefits, not just pensions and other post-retirement benefits. Many entities have not recorded a holiday pay accrual. Where the level of attrition in the workforce is relatively static, the movement in the accrual year on year may be minimal. However, where no accrual exists at transition, an adjustment will be required. The starting conversation for this adjustment should be with the human resources team, not the finance team, as the need for an adjustment should reflect the company's annual leave policy and, indeed, how that policy is enforced.

### Defined-benefit pensions

The number of such plans may be smaller than in days past, but where they arise, they often do so in a group situation. In current Irish GAAP that generally means that the pension asset or liability is recognised in the consolidated financial statements but not in any entity's individual financial statements. The new framework requires that the asset or liability be recorded by the entity that has a commitment to the employees. In a group situation, this will, at the very least, be the sponsoring employer (thus potentially having a negative impact on distributable profits), but it may affect other companies in the group where they have, by means of a side letter, committed to funding part of the defined-benefit obligation. For those entities that are closing such a scheme and settling the obligation with, for example, a third-party insurer, there is also a difference in the measurement date of when a gain or loss on settlement must be recorded.

### Consolidation

Particularly in the asset management industry, when deciding to either use FRS 102 or IFRS, the consolidated principles require careful attention in respect of funds and special-purpose entities. Factors such as whether performance fees are fixed or variable will be pertinent.

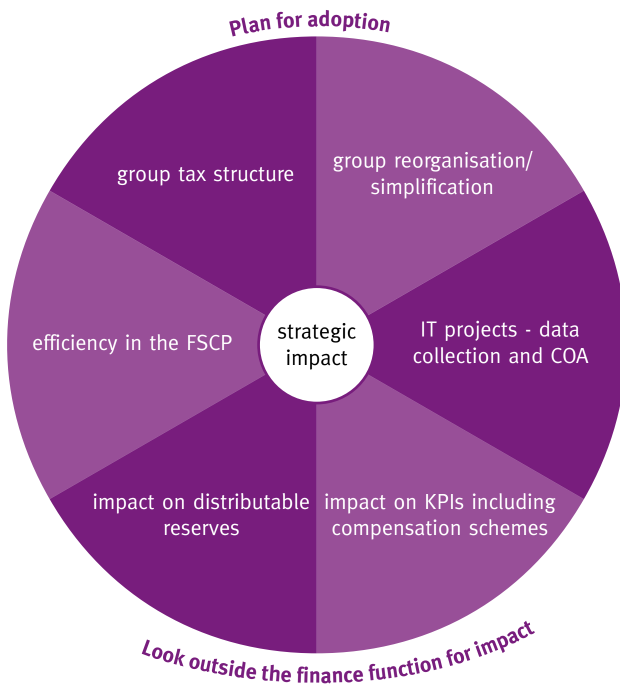
### Inter-company balances

This, the most common area for discussion, gives rise to much head scratching and demonstrates why IFRS-based accounting was not really intended for use in single-entity financial statements. If we leave aside inter-company trading balances that are settled regularly, the issue arises with balances that are longer term and therefore may contain a financing aspect. Often such balances have no interest rate attached, but because FRS 102 and IFRS require financial instruments to be measured at fair value, this can lead to the need to account for notional interest in the financial statements. Despite the fact that the interest is notional, and in group situations it will cancel on consolidation, it requires a certain amount of administrative maintenance, the burden of which sits with the finance function.

## Look Outside the Finance Function

Notwithstanding the items noted above, perhaps the biggest pitfall of any GAAP conversion is thinking that it is purely a technical accounting exercise. Figure 2 illustrates a number of aspects to consider, which often involve input from outside the finance function.

**Figure 2: Business-wide considerations in conversion to the new framework**




### Group structure: exporting and overseas operations

If your business model involves exporting products or if you have some overseas operations, perhaps through a branch structure rather than a subsidiary, there is a little more complexity and change. Many companies involved in the export market may have taken advice from their bankers about how to insulate themselves from the risk of foreign exchange movements. This may have resulted in entering forward foreign exchange contracts. Forward contracts are considered to be "non-basic" financial instruments in the new guidance and as such must be fair-valued at each balance sheet date, with corresponding movements recognised in the profit and loss account. Although the forward contracts will have hedged the foreign currency exposure, they will introduce volatility to the profit and loss account. At the very least, this will require greater explanation to those shareholders, directors and other stakeholders who do not have a finance background.

Both IFRS and FRS 102 provide more detailed guidance on the determination of functional currency than the old Irish GAAP. If an overseas business is operated through a branch structure, determining the appropriate functional currency of that overseas operation will require some careful attention. In our experience this area can cause difficulties, either because the functional currency was not appropriately focused on at the inception of the business or because the circumstances of the business have changed over time without a consequential reassessment of the functional currency. Changes to functional currencies for UK business can have adverse tax cash-flow consequences.

### Efficiency in the financial statements close

The reduced disclosure framework in FRS 101 is an opportunity to introduce some efficiency to the financial statements close process in a group situation. Whether the parent is producing consolidated financial statements in accordance with IFRS or FRS 102, where the subsidiary companies meet the definition of a qualifying entity, the subsidiary can substantially reduce the note disclosures in its financial statements.

The disclosures that can potentially be excluded fall into two categories. One is disclosures that can be excluded only if an equivalent disclosure is provided in the group financial statements, for example, share-based payment. The other is disclosures that can be omitted whether or not an equivalent disclosure exists in the group, for example, the cash-flow statement or related-party disclosures in the subsidiary financial statements.

The quantum of the reduced disclosures will depend on the company's complexity and its industry, but for many entities a reduction of up to 30% may be achievable. Where the group has a large number of companies, the reduced effort required in completing statutory financial statements frees up time for more operational finance activities such as budgeting or financial planning and analysis.

### Impact on IT infrastructure

For any entity considering a change of accounting software or an upgrade to an existing system, it is important to evaluate the impact of these new accounting guidelines. Implementing a

chart of accounts (COA) based on current Irish GAAP would seem like a poor investment of resources if it needs to be revised on conversion to either IFRS or FRS 102. Although a manual work-around through a spreadsheet system will be possible, this again feels like wasted effort, in addition to the control risk that can arise from an over-reliance on spreadsheets. Ensure that the IT manager or project team is aware of the change that will occur to the financial statements.

### Tax impact

If your organisation operates in both Ireland and the UK, tax is one area where you cannot assume that the impact will be the same in both sets of statutory accounts. As I understand it, in the UK there are specific rules on to how each conversion adjustment is treated. Accounting policy choices can therefore impact on tax cash-flows. Functional currency and operating lease incentives are two areas that have affected the corporate tax figure for at least some UK entities.

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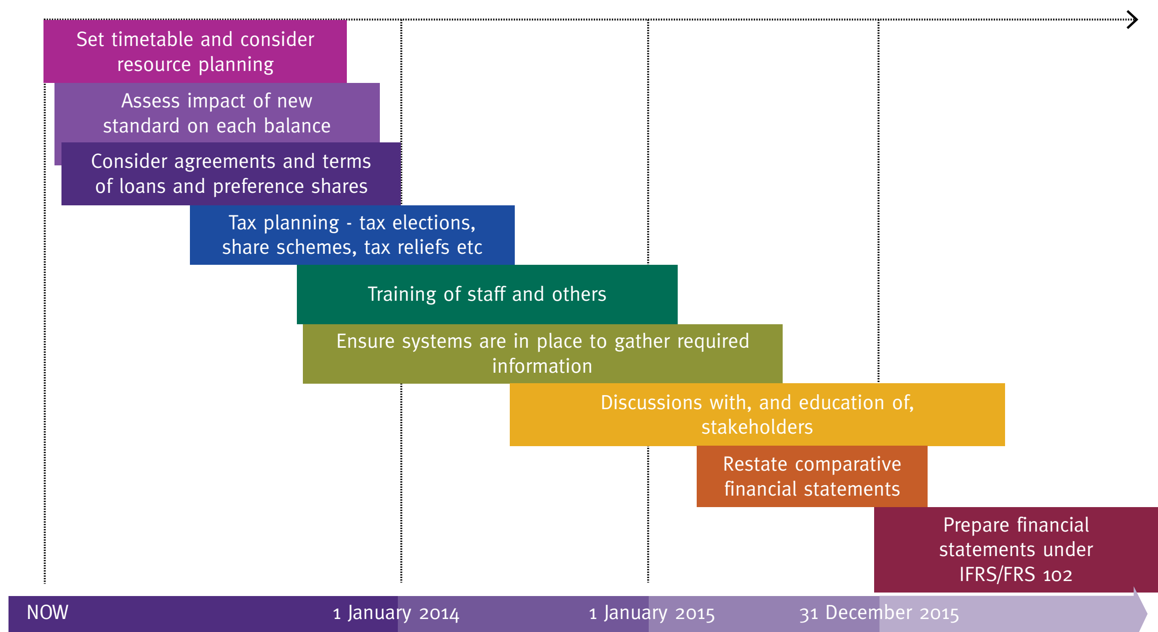
From an Irish tax perspective, the rules that applied when companies converted to IFRS in 2005 will apply to companies now on conversion to FRS 102. The theory is that no entity should suffer a tax loss or receive a tax benefit from the transition from IFRS to FRS 102. Broadly, where conversion adjustments occur that give rise to a tax impact, the tax effect is to be dealt with over a five-year transition period.

## Practical Next Steps

Competing strategic priorities have determined whether a company has made the change or has yet to commence. Where an entity is just starting to plan the change, there are some practical steps that need to occur in order to prepare. The first of these is to consider the strategic impacts outlined above and to make an informed decision about a timetable (see Figure 3). Having an outlined plan for the change will be important when communicating with stakeholders such as the board, share-holders or even the Revenue Commissioners.

Remember also that the 2015 financial statements need to have comparative numbers for 2014 and an opening balance sheet at the transition date. So continuing to stick one's head in the sand will create problems, particularly for gathering data feeds where the IT system does not allow it to be done retrospectively.

**Figure 3: Next steps in conversion to the new framework**



## Conclusion

With all GAAP conversion projects, the devil is in the detail. However, the most important aspect is to avoid the temptation of diving straight into the detail! No matter what your state of preparedness, stand back, consider the impact on the business both commercially and functionally and put a plan together. And what better time to consider it than now, as most organisations come out of the year-end close process.

Read more on TaxFind Tax Accounting under FRS 102, *Irish Tax Review*, Issue 2, 2013; Tax Accounting: Current and Deferred Tax, *Irish Tax Review*, Issue 2, 2014. Taxes Consolidation Act 1997 Notes for Guidance (Finance Act 2014 Edition), Schedule 17A: Accounting Standards

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