THE NEW IRISH GAAP

December 2013
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John McCarthy Consulting Limited

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AGENDA

1. What?
2. So what?
3. Now what?

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WHAT?

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effective for a/c periods starting 1/1/2015

- FRSSE – *'Financial Reporting Standard for Smaller Entities'*
- Old version April 2008, Latest version July 2013
- Not available to companies limited by guarantee
- 'Small' entities = TO < €8.8m; BS < €4.4m; Ee < 50
- FRS 102 – *'The Financial Reporting Standard Applicable in the UK and Republic of Ireland'*
- All non-listed entities ('small entities may use it)
- Published March 2013 www.frc.org.uk

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- FRS 100 – *'Application of Financial Reporting Requirements'*
- *Read this once*
- FRS 101 – *'Reduced Disclosure Framework'*
- European Union (IFRS) Regulations 2012 (SI 510)
- Effective 13 December 2012 (early adoption allowed)
- Certain subsidiaries of parents using IFRS

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SO WHAT?

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WHAT'S NEW?

- Not dealing further with FRS 100 or FRS 101
- 35 sections in FRS 102 - 335 pages v 2,500 pages + old GAAP
- New regime for financial instruments
- New requirements for defined benefit pension plans
- Investment properties at fair value - gains/losses – P & L
- Charities = 'PBE' (Public Benefit Entities) included
- Biological assets now dealt with

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WHAT'S NEW?

- More intangible assets to be recognised separately from goodwill where there is a business combination
- Additional deferred tax to be recognised, for example on revaluations of property, plant and equipment
- More widespread use of IFRS terminology like…..
- 'Amortised cost' - mentioned 25 times in FRS 102
- 'Fair value' – mentioned over 360 times in FRS 102!!!!
- Only a cross-section of the changes

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Topic	FRSSE	FRS 102
Cash flow statement	None required	Required, with exceptions
Investment property	Market value changes to STRGL	Fair value changes to PL A/c
Financial instruments	Not dealt with	Most derivatives on the balance sheet for the first time, at fair value
Listed investments	At cost or FV	FV only
Deferred tax	No recognition on revaluations	Recognition on revaluations
Employee Benefits -	Little guidance	Recognise short term benefits
Foreign currency	Can use contract rate	Cannot use contract rate
Specialised activities	Not addressed	Livestock, biological assets
Goodwill amortisation	20 year max assumed life, with rebuttable presumption	5 year max assumed life, with exceptions if supporting proof

Topic	FRS 102	IFRS
Cash flow statement	Required, with exceptions	Required
Investment property	Fair value changes to PL A/c	Fair value changes to PL A/c
Listed investments	FV only	FV only
Financial instruments	Most derivatives on the balance sheet at fair value	All derivatives on the balance sheet at fair value
Deferred tax	Recognition on revaluations	Recognition on revaluations
Employee Benefit	Recognise short term benefits	Recognise short term benefits
Foreign currency	Cannot use contract rate	Cannot use contract rate
Specialised activities	Addressed e.g. Agriculture i.e. Livestock, biological assets	Addressed e.g. Agriculture i.e. Livestock, biological assets
Goodwill amortisation	5 year max assumed life, with exceptions if supporting proof	Indefinite life, subject to impairment review

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- NOW WHAT?

- The Main Changes

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1. Deferred Tax

- DT on virtually all timing differences – incl. property revaluations and FV adjustments on acquisition
- Discounting DT prohibited – any previous discounting needs reversed
- Additional liabilities onto BS, reducing assets/reserves + potentially reducing distributable reserves
- FV adjustments - FRS 102 via goodwill on acquisition

2. Investment Properties

- Normal basis will be fair value with changes in FV through profit and loss (not STRGL)
- Investment property cos. + other cos. holding inv. props. likely to see greater earnings volatility
- DT on valuation adjustments - but will be ‘unrealised’
- Allowed use historic cost if *‘undue cost/effort involved’*
- ‘Cost’ model requires depreciation, except on land
- Letting to group co. allowed (unlike current SSAP 19)
- Interest held as op. lease – treat as finance lease

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3. Goodwill and intangibles

- Current GAAP = amortised over useful life, subject to rebuttable presumption of max life of 20 yrs. or less
- FRS 102 estimated life must not exceed 5 yrs., unless reliable basis for justifying longer life
- Potentially significant adjustment for companies that don’t already have robust basis for estimated useful life
- No option for annual impairment reviews

4. Identification of intangibles on acquisition

- Current GAAP = goodwill on acq./consol = diff in FV of consideration and FV of separable net assets
- FRS 102 requires consideration of FV of separately ‘identifiable’ net assets
- Likely to have several intangibles such as customer lists, licences, royalties, etc. and smaller goodwill number
- EXCEPTION - If acq. in bus. combination – do not separate when arising from legal/contract rights + FV can’t be identified

5. Defined Benefit Pensions

- Now – recognise service cost + expected return on plan assets based on avg. return over remainder of scheme + int. cost on liabilities (i.e. reflecting expected increase in PV of plan liabilities when discount unwinds as benefits come closer to settlement) + Gains/losses to STRGL
- FRS 102 – recognise service cost + net interest on DB asset/liability (i.e. interest rate on high quality bonds) + gains/losses to OCI
- Net liability the same, but reduced finance costs charge to P&L and greater charge in OCI = reduced profits
- Could lead to reduced profits/broken covenants

6. Changes in equity stake

- Where parent increases stake in subsidiary
- Currently subs. separately identifiable net assets are revalued to FV + adjust goodwill
- Decreases in stake – gain/loss on disposal
- FRS 102 – if change causes no loss of control – treated as transaction with equity holders
- No impact on profit/loss

7. Financial instruments

- Basic (11)   Other (12)
- Trade debtors, trade creditors, simple bank loans and many investments
- Generally measured at amortised cost (like FRS 4)
- Investments in non-convertible ordinary/preference shares (i.e. without contractual conditions like options) - ordinary shares/pref. shares are at FV or cost less impairment

7. Basic financial instruments

Similar to FRS 4	Initial measurement	Subsequent measurement	Impairment testing
Debtors – financing transactions – payment deferred or not at market interest rates	Present value of cash receivable	Amortised cost	Carrying amount vs present value of estimated cash flows
Creditors – financing transactions - payment deferred or not at market interest rates	Present value of cash payable	Amortised cost	
Bank loans payable – with 'basic loan' features	Present value of cash payable	Amortised cost	

7. Basic financial instruments

	Initial measurement	Subsequent measurement	Impairment testing
Investments in debt Bonds, debentures etc.	Transaction price including transaction costs	Amortised cost	Carrying amount vs present value of estimated cash flows (as in FRS 4)
Investments in shares – where FV cannot be reliably measured	Transaction price including transaction costs	Cost less impairments	Carrying amount vs estimated selling price (different from FRS 4)
Investments in shares – publicly traded or FV can be reliably measured	Transaction price excluding transaction costs	At fair value with gains/losses to P&L	

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8. 'Other' financial instruments

- Those that are not basic
- Derivatives such as foreign exchange forward contracts +complex loan arrangements (int. rates linked to commodity prices/equity prices where + or - effect)
- Current Irish GAAP - not recognised on BS and gains/losses recognised on settlement
- FRS 102 – recognised on balance sheet - almost all at FV
- Gains/losses through P&L

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9. Other main changes

- Holiday pay accruals – provide for all obligations to ‘ees
- Leases – SSAP 21 has 90% test, FRS 102 does not
- Use of IFRIC 4 language
- <u>Foreign exchange forward contracts</u>
- SSAP 20 allows contract rate
- FRS 102 – recognise fx contract as fin. Instrument @ FV
- Associated debtor/creditor retranslated at YE rate
- Hedge accounting – specific criteria need to be met

'Fair value' – what's that?

- Not the same as market value/existing use
- *'The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction. In the absence of any specific guidance provided in the relevant section of this FRS, the guidance in paragraphs 11.27 to 11.32 shall be used in determining fair value'.*
- Value – potential to demolish hotel and build something else that could be more valuable/have greater potential

‘Amortised cost’

- *‘The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectability’*
- ‘Effective interest method’
- *‘A method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period’*

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Example of amortised cost in action

- **Interest Free Loan On Five-Year Fixed Term**
- A subsidiary company adopts FRS 102 for its December 2015 accounts and has a 1 January 2014 transition date
- At the beginning or 2012 it took out a €1m interest free loan from its parent company, with a 5yr. fixed term
- Assuming it can determine that a market rate of interest at the time would have been 12%, it can go back to the inception date and establish what the accounting would have been from the outset

Example of amortised cost in action

	Opening Value	Interest at 12%	Closing Value
2012	567,427	68,091	635,518
2013	635,518	76,262	711,780
2014	711,780	85,414	797,194
2015	797,194	95,663	892,857
2016	892,857	107,143	1,000,000

- The 2013 closing value of €711,780 is used as the carrying value in the transition date balance sheet, and the accounting continues from there
- FRS 102 is silent about where the difference goes!!

‘Transition date’

- “Transition date” – really important concept
- Say ‘31 December 2014’ is period end
- First full financial year under FRS 102 = 31/12/2015
- Last financial period under current Irish GAAP = 2014
- Therefore the ‘Transition date’ = 1 Jan 2014
- 2014 requires two sets of accounts
- ‘Old GAAP’/FRS 102

Things to do before transition date

1. Identify the 5 prohibited restatements (i.e. retrospective application) such as accounting estimates (para 35.9)
2. Select one or more of 17 exemptions available
3. Consider timing of acquisitions before/after transition
4. Identify forward contracts, caps and collars and interest rate swaps i.e. financial instruments
5. ‘Profit’ related remuneration – profit different?
6. Tax implications – tax will usually follow GAAP

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Things to do before transition date

7. Dividend planning – will dividends be different?
8. Controls may need redesigned
9. Investors/lenders may need re-educated
10. Accounting policies may need updated
11. Obtain fair values as at 31 December 2013 – *ask bank*
12. Examine banking covenants + renegotiate if needed
13. Systems and procedures – are they set up to capture items that need fair values?

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Things to do before transition date

14. Make holiday year the same as your financial year and allow no carry forward of unused holidays
15. Prepare and present reconciliations and disclosures
16. Employees may need training
17. Change accounting date to postpone transition!!
18. Remain calm!

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