

Your questions answered

The future of Irish GAAP

January 2011

Introduction

The UK Accounting Standards Board (ASB) has indicated that its overarching strategy is to achieve a common financial reporting framework for use in the UK and Ireland. The International Accounting Standards Board's (IASB) publication of the IFRS for Small and Medium-sized Entities (IFRS for SMEs) in July 2009, led the ASB to propose moving to an IFRS-based framework for all but the very smallest entities in the UK and Ireland.

The ASB issued Financial Reporting Exposure Draft (FRED) 43: Application of Financial Reporting Standards and FRED 44: Financial Reporting Standard for Medium-Sized Entities in October 2010 outlining a proposed future for financial reporting in the UK and Ireland. These proposals follow the ASB's review of comment letters received in response to their Consultation Paper 'Policy proposal: The future of UK GAAP', issued in August 2009.

This document answers a number of common questions about the proposals and implications of the ASB's proposals.

The proposed effective date for the ASB's proposals is financial years beginning on or after 1 July 2013. The ASB has agreed a minimum transition time of 18 months from the publication of a new standard to the effective date.

Nature and scope of the proposals

What is the ASB proposing?

The ASB is proposing a 3-tier system of financial reporting, with most UK and Irish entities reporting under either EU-adopted IFRS (IFRS or 'full IFRS') or Financial Reporting Standards for Medium-Sized Entities ('FRSME'), the ASB's version of the IASB's IFRS for SMEs.

An entity's reporting requirements would be based on whether the entity is 'publicly accountable' (see definition below) rather than the entity's size. The ASB's Financial Reporting Standard for Smaller Entities (FRSSE) would continue to be an option for qualifying entities.

The 3 proposed tiers are:

- Tier 1 – EU-adopted IFRS for publicly accountable entities
- Tier 2 – FRSME for entities that are not publicly accountable
- Tier 3 – FRSSE for small entities..

In addition, an option for applying reduced disclosures would be available for qualifying subsidiaries within Tier 1 and Tier 2 (see overleaf).

Entities would also be permitted to report under requirements of a higher tier.

What is the definition of publicly accountable?

The ASB is proposing to largely adopt the definition of public accountability used in the IFRS for SMEs, amended to include deposit-taking entities. The ASB have also included more guidance on application of the definition.

The ASB has proposed that: An entity has public accountability if:

- a) at its reporting date its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or
- b) as one of its primary businesses, it holds assets in a fiduciary capacity for a broad group of outsiders and/or is a deposit-taking entity for a broad group of outsiders. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds or investment banks.

What does this mean in practice?

The ASB has included application guidance in FRED 43 to assist entities in determining whether they have public accountability.

The FRED lists the following entities as having public accountability: quoted companies, pension schemes, insurance companies, credit unions, building societies, incorporated or registered friendly societies, banks, employee benefit trust, investment and mutual funds, custodians and brokers.

Deposit-taking entities or entities that hold assets in a fiduciary capacity for a broad group of outsiders are publicly accountable because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity.

However, if they do so for reasons incidental to their primary business that does not make them publicly accountable. Examples include travel or real estate agents, schools, charitable organisations, co-operative enterprises requiring a nominal membership deposit, and sellers that receive payment in advance of delivery of the goods or services.

‘Broad group of outsiders’ refers to ‘outsiders’ that are not involved in the management of the entity and rely on general purpose financial statements as they do not have the power to demand additional financial information.

However, the proposals include a relief from applying EU-adopted IFRS for certain publicly accountable entities that are prudentially regulated, such as a credit union or building society, where the entity meets all three conditions of being a small company in Company Law (turnover €3.8 million, balance sheet total €1.9 million, average number of employees 50). Such entities would be permitted to use the FRSME.

Are public benefit entities included in the definition of publicly accountable?

Public benefit entities (PBEs), including charities and other not-for-profit organisations, generally fall outside the ASB’s proposed definition of public accountability. The ASB has stated that it plans to develop a separate PBE standard in compliance with the FRSME. This will be developed on a different timeline from the current proposals. The ASB anticipates a PBE standard to be completed in 2011.

How about very large private companies? Would they be publicly accountable?

No. The new 3-tier structure is not based on company size. A large private company that is not a deposit-taking entity and doesn’t hold assets in a fiduciary capacity for a broad group of outsiders would be entitled to use the FRSME.

Would there be any relief available to subsidiaries?

Publicly accountable subsidiaries should apply EU-adopted IFRS. However, non-publicly accountable subsidiaries would be able to benefit from a reduced disclosure option.

Following strong demand from respondents to their consultation paper the ASB has proposed that qualifying non-publicly accountable subsidiaries in both Tier 1 and Tier 2 would be able to avail of disclosure exemptions.

What size of company can use the FRSSE?

The ASB’s Financial Reporting Standard for Smaller Entities (FRSSE) sets out which entities are within its scope. Its use is limited to small companies as defined in C(A)A86.

What will happen with the industry-specific SORPs?

Responses to the ASB’s Consultation Paper were clear that SORPs contribute to improved financial reporting and promote consistency of accounting within certain industries. The ASB is proposing to reduce the number of SORPs over time, but to retain SORPs where there is a clear and demonstrable need.

Why change UK and Irish GAAP?

UK and Irish GAAP has been steadily moving closer to IFRS as the ASB has followed its conversion agenda.

The ASB’s view is that the IFRS platform (particularly now the IASB has issued the IFRS for SMEs), provides a high quality, fit-for-purpose, financial reporting framework that comprehensively addresses all entities that are required to prepare financial statements (other than the public sector). For this reason the ASB sees no reason to maintain a separate set of UK and Irish standards. The ASB has stated that the proposals would improve financial reporting in the following ways:

- Reporting may be simplified, based on the entity’s accountability obligations.
- The widespread use of IFRS provides comparability and consistency for preparers and users, and advantages in terms of education for accountants and auditors.
- The UK and Irish standard setting resources would be better placed to influence the IASB’s activities and ensure IFRS satisfies the needs of the regions’ reporters.

The ASB has consistently emphasised that balancing the cost to entities and benefit to users remains a key priority.

FRSME – the standard and its adoption

What is the FRSME?

The FRSME (Financial Reporting Standards for Medium Sized Entities) is the ASB's version of the IFRS for SMEs. The IFRS for SMEs as developed by the IASB has been amended for UK/Irish - specific circumstances.

The ASB is proposing that entities falling into Tier 2 would apply the FRSME.

What is the IFRS for SMEs?

IFRS for Small and Medium-sized Entities (IFRS for SMEs) is the IASB's simplified IFRS (230 pages rather than the 2,000 pages of the IFRS bound volume) for entities that are not publicly accountable. The IASB published the IFRS for SMEs in July 2009.

Although based on IFRS, the IFRS for SMEs contains some different measurement, recognition and disclosure rules.

For example:

- Under IFRS for SMEs, goodwill is amortised over a period of 10 years in the absence of a better alternative, as opposed to being subject to an annual impairment test under IFRS.
- IFRS for SMEs includes a simplified option for accounting for financial instruments, although it does permit a company to elect to apply full IFRS for this area only.
- IFRS for SMEs prohibits measuring property, plant and equipment at valuation.

How has the IFRS for SMEs standard been amended for use in the UK and Ireland?

The ASB aimed to make minimal change to the IFRS for SMEs in developing the FRSME.

However, five amendments to the IFRS for SMEs were necessary to ensure that the ASB's version of the IFRS for SMEs complies with UK and Irish Company Law and the EU accounting directives.

The ASB has also proposed that the income taxes section of the FRSME is the equivalent IFRS standard IAS 12 'Income Taxes'. The tax section of the IFRS for SMEs anticipated changes to IAS 12 that were subsequently deferred.

The ASB is also proposing to retain the existing cash flow and consolidation exemptions in the UK and Ireland.

Would FRSME be a stable platform?

The ASB plans to implement the FRSME as per the FRED. The ASB intends to update the FRSME only at regular intervals and would consult on the potential application of any proposed changes to the IFRS for SMEs.

The IASB has indicated that there will be no change to the IFRS for SME standard in the first three years following its publication. A thorough review of the IFRS for SMEs will be undertaken when a broad range of companies have filed two years' financial statements prepared using the IFRS for SMEs. The review will take into consideration new and amended IFRSs since 2012.

What are some of the key advantages of using FRSME compared to using IFRS?

The advantages of using the FRSME over IFRS include:

- Simpler accounting. For example, there is no option to measure property, plant and equipment at valuation, all borrowing costs and development expenditure is recognised as an expense immediately.
- Less disclosure – notably financial instruments disclosures and impairment of assets.
- There may be cash tax and distributable reserves benefits for some companies.

What are some of the key disadvantages of using FRSME compared to using IFRS?

FRSME is different from IFRS, not just a simplified version of full IFRS. The disadvantages include:

- Simpler accounting may result in accounting policies that certain entities would not find attractive. For example, immediate expensing of development and borrowing costs and amortisation of goodwill.
- FRSME would not be accepted for use in a listing document and subsequent filings. This would affect companies preparing for an IPO.

What is the expected timing for the introduction of an IFRS based framework in the UK and Ireland?

The ASB is proposing that FRSME would be applicable for periods beginning on or after 1 July 2013. That is, a Tier 2 entity with a 31 December year end would be required to prepare financial statements in accordance with FRSME for its year-end 31 December 2014, with comparatives for the year ended 31 December 2013 and an opening balance sheet of 1 January 2013.

What is the ASB's timeline for adoption of the FRSME standard, and the introduction of a tiered approach in the UK?

October 2010 - ASB released two FREDs on the proposed mandatory adoption of IFRS for all UK and Irish entities (excluding those that qualify for reporting under the FRSSE).

April 2011 - Deadline for comments on the FREDs.

Mid 2011 - Final standard expected.

July 2013 - Mandatory effective date for adoption of IFRS or the FRSME (based on the FREDs).

June 2014 - Entities with financial years ending June 2014 would be the first entities required to prepare FRSME financial statements.

As a global organisation, how beneficial would it be to adopt the FRSME?

IFRS for SMEs is a global standard; FRSME would amend the IFRS for SMEs in small ways to achieve compliance with the EU accounting directives.

There is a risk that the simplicity of accounting prescribed by the FRSME may reduce the benefits in a global organisation. Since FRSME introduces certain different measurement principles from full IFRS, it would not be appropriate for all organisations.

Which other countries will be adopting the IFRS for SMEs standard?

To date a number of countries have adopted or indicated that they intend to adopt the IFRS for SMEs, including South Africa, Brazil, Argentina and Hong Kong.

Can a group choose which of its companies will apply full IFRS or FRSME?

Current Irish company law requires groups to apply a consistent GAAP across all entities unless there is a 'good reason'. One exception is that the parent of listed IFRS groups may use IFRS without mandating use of IFRS by all the subsidiaries.

The ASB has indicated that groups would have the option of making the decision on an entity by entity basis, meaning that a group may contain both IFRS and FRSME reporters.

Could an entity opt for the FRSME even if its foreign parent company undertakes full IFRS adoption?

An entity currently reporting under Irish GAAP that is not publicly accountable could adopt FRSME even if its parent applies full IFRS.

All Irish entities should determine the most beneficial set of accounting standards to adopt, taking into account factors such as the impact on tax, distributable reserves, covenants and any specific parent company views.

Adopting IFRS

Why should entities be interested in moving to IFRS now instead of waiting for the mandated change?

FRSME will not be available for Irish entities to adopt until the ASB have finalised their current proposals. However, all Irish entities are currently entitled to adopt IFRS. Therefore certain entities may elect to adopt IFRS now rather than waiting for the ASB's proposals to become effective.

- Entities that would have to adopt full IFRS under the ASB's proposals should consider moving earlier rather than later to ensure a successful approach to planning the conversion.
- There may be a cash benefit through the tax implications of moving to full IFRS. This would need to be assessed on a case-by-case basis, but is a key consideration.
- Large multinationals may benefit from the use of shared service centres for the preparation of entity financial statements if full IFRS is applied in several countries.
- Irish GAAP to IFRS adjustments that need to be made for group reporting purposes would be removed where the parent company is already reporting under IFRS.
- Statutory accounting would have a similar framework to group reporting – although there may still be differences.

What else should management be thinking about now?

While IFRS or FRSME is not yet mandated for all entities, the ASB's proposals mean a move to an IFRS framework of accounting is imminent. Management should start monitoring developments in the ASB's proposals and consider the impact of a GAAP change on projects and transactions it is currently undertaking. Actions include:

- Appointing a responsible individual within the organisation for monitoring developments.
- Considering the impact of a future GAAP change on projects such as corporate simplification, XBRL, development or changes to shared services centres.
- Understanding the potential impact on cash taxes or distributable reserves under IFRS or FRSME, when undertaking transactions.
- Forward planning to identify potential issues affected by conversion to IFRS or FRSME, such as the impact on:
 - Cash taxes payable
 - Distributable reserves
 - Bank or loan covenants
 - Contractual arrangements (where they are GAAP dependent in any way)
 - Management bonus schemes
 - Commercial implications of increased disclosures where they may be commercially sensitive, e.g. related party transactions

Find out more

How can I find out how FRSME differs from Irish and UK GAAP?

A similarities and differences publication comparing IFRS, FRSME and UK GAAP is available.

Alternatively, talk to your local PwC contact.

What publications are available?

- IFRS for SMEs: Pocket guide
- Similarities and differences: A comparison of IFRS for SMEs and 'full IFRS'
- IFRS for SMEs: Illustrative consolidated financial statements 2010

Publications can be downloaded from www.pwc.com/ie/ifrsforsme, www.pwc.com/ifrs or www.pwcinform.com.

Hard copies can be ordered from www.cch.co.uk/ifrsbooks

Contacts

Irene O'Keefe

Partner
353 (0) 1 792 8563
irene.okeefe@ie.pwc.com

Fiona Hackett

Senior Manager
353 (0) 1 792 5413
fiona.hackett@ie.pwc.com

Emer Keaveny

Senior Manager
353 (0) 1 792 6718
emer.keaveny@ie.pwc.com

www.pwc.com/ie/ifrsforsme

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