

Are you ready for the end of Irish GAAP?

Points of view by Irene O’Keeffe

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The vast majority of Irish companies that currently prepare their accounts using Irish GAAP (generally accepted accounting practice) look likely to have to face the prospect of a new accounting framework in the years ahead. Irene O’Keeffe, IFRS Partner, PricewaterhouseCoopers answers some topical questions on the future of Irish GAAP, including the current proposals of the Accounting Standards Board (ASB) on introducing the IFRS for SMEs. She also outlines some practical actions to consider in advance of the new framework.

Why is financial reporting in Ireland about to change?

In 2005 the ASB decided on a strategy to converge with International Financial Reporting Standards

(‘full IFRS’) over a period of years. Consequently, UK/Irish GAAP has moved closer to IFRS as the ASB changed the accounting rules on areas as diverse as accounting for preference shares as debt, no longer recognising proposed dividends as liabilities and recording expenses for share options.

However, now that the International Accounting Standards Board (IASB) has issued its IFRS for SMEs accounting standard, the ASB strategy has changed. The IASB’s standard, IFRS for SMEs, is designed to be a complete accounting framework suitable for all companies, big and small, except those that are regarded as ‘publicly accountable’. The ASB considers that the IFRS for SMEs framework is as suitable for non-publicly accountable companies in the UK and Ireland, as it is for the rest of the world. As a result, the ASB’s proposals would see the end of UK/Irish GAAP as we currently know it and a transformation of the reporting framework of thousands of Irish entities. For companies that are publicly accountable, the ASB proposes they would have to use full IFRS.

Many accountants have asked the question ‘Why is there a need to introduce a new accounting framework; why is UK/Irish GAAP not fine as it stands?’ The answer lies in

Table 1: ASB's proposed financial reporting framework

Tier	Reporting framework	Criteria
Tier 1	EU-adopted IFRS (full IFRS)	Publicly accountable companies
Tier 2	IFRS for SMEs	Companies that are not 'publicly accountable'
Tier 3	FRSSE	Companies that qualify as small

the current partly-converged state of UK/Irish GAAP, together with the global shift toward the use of either full IFRS or IFRS for SMEs. These factors have led the ASB to conclude that things cannot stay as they are.

ASB's proposals

At the heart of the ASB's proposals is a new 3-tier system of reporting; based largely on the concept of 'public accountability'. (See table 1 below.) The proposals would see most UK and Irish companies having to report under either IFRS or IFRS for SMEs. The Financial Reporting Standard for Smaller Entities (FRSSE) would continue to be an option for entities that qualify as small.

Within the three tier structure all entities in tiers 2 and 3 would be permitted to voluntarily opt up to the reporting framework applicable to higher tiers. For example, a tier 2 entity could choose to use full IFRS, rather than IFRS for SMEs, perhaps in anticipation of a future listing.

Who would be eligible to use IFRS for SMEs?

All profit-seeking companies that are not regarded as publicly accountable would be eligible to use the IFRS for SMEs.

Based on the ASB's proposals an entity has 'public accountability' if;

- its debt or equity instruments are traded in a public market, or if it is in the process of issuing such instruments for trading in such a market,

or

- it is a 'deposit-taking entity' or if it holds assets in a fiduciary capacity for a broad group of outsiders as

one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

The definition of 'public accountability' is key to the ASB's proposals and this concept has been the primary focus of many of the interested parties that sent in responses to the proposals.

Are very large private companies regarded as publicly accountable?

The ASB's proposed 3-tier structure does not have regard to size. A large private company that is not publicly accountable could use the IFRS for SMEs. However, this is an area on which ASB has specifically looked for comment and is therefore subject to debate.

Will charities and other not for profit entities be required to adopt a new accounting framework?

While the ASB's proposals are more precise in relation to profit-seeking entities, they also recognise the importance of the charity and not for profit sector. The ASB has asked for comment from this sector on the best answer for it, and indeed the ASB Chairman, Ian Mackintosh addressed a wide cross-section of representatives of the sector in Dublin earlier this year. One of the options offered by the ASB is that it would develop a separate standard specifically designed for this sector. This is timely in the context of the relevant Government Department currently considering the reporting aspect of how to regulate the charity sector in Ireland.

Should there be a 4th tier allowing 'full' IFRS reporting with SME disclosures for wholly-owned subsidiaries of public companies?

Under the proposals publicly accountable subsidiaries should apply IFRS. However, many subsidiaries in a group where the parent is publicly accountable would be categorised as 'tier 2' entities and entitled to use either IFRS for SMEs or full IFRS.

Initial indications from the responses to the ASB suggest that a number of respondents would favour a '4th tier' within the financial reporting framework which would permit subsidiaries of IFRS reporters to prepare IFRS financial statements, but with reduced disclosures. The ASB has tentatively agreed to research the possibility of subsidiary entities applying full IFRS for recognition and measurement, but with reduced disclosures.

Should I switch to IFRS now or wait for the final outcome of the ASB's proposals?

While IFRS for SMEs is simpler than IFRS in terms of accounting and disclosure, it may not be the appropriate choice for all tier 2 entities. For example, the subsidiaries of some listed companies have already switched to IFRS. This approach avoids the need to operate both IFRS for group reporting purposes and UK/Irish/local GAAP for statutory accounts purposes. In contrast, others consider that the upheaval of implementing a new basis of accounting would outweigh the benefits of transitioning to IFRS.

In other words, the decision for many entities is much more than a mere accounting one.

Some banks and insurance companies that would have to switch to IFRS under the proposals may consider it wiser to introduce IFRS now rather than waiting until a time when there may be more challenging projects to be faced by the organisation.

Some multinationals may benefit from the use of shared service centres for the preparation of entity financial statements if IFRS is applied in

Table 2: ASB proposals timeline

August 2009	ASB consultation paper proposing mandatory adoption of either IFRS or IFRS for SMEs for all UK/ Irish entities (other than small companies that are entitled to report under the FRSSE).
February 2010	Deadline for responses to the consultation paper
2010	ASB exposure draft expected having considered the responses to the proposals
2011?	Final ASB standard – possibly effective for 2012*

* There was little support from the responses to the ASB's proposals for the proposed application date of 1 January 2012. The ASB has tentatively agreed to a one year deferral for transition, with earlier application being permitted.

several countries.

Until now, a legitimate concern about the depth of knowledge and experience of IFRS may have held back transition to IFRS. This concern is being allayed year by year as proficiency in IFRS increases and, in addition, UK/Irish GAAP is now more closely aligned with IFRS than it was some years ago.

The impact on distributable reserves, tax, covenants and guarantees, as well as the preferences of lenders and other stakeholders, are likely to be factors influencing this decision.

Since 2005 a number of private companies, such as subsidiaries in EU groups, have voluntarily adopted IFRS in order to streamline their consolidation process, while others have considered the benefits of transitioning before concluding that these were outweighed by the upheaval of implementing a new basis of accounting. However, the key change since 2005 is that a move away from current UK/Irish GAAP is inevitable whether this is now, or in 2013.

When will the new requirements be finalised?

The ASB issued its proposals for comment in August 2009 and it has received in excess of 150 responses to those proposals. While most of the responses support the use of IFRS for SMEs, the ASB will review the suggestions on where it should be amended; this could include incorporating the existing company law exemptions from preparing consolidated accounts.

What action should management take now?

If the new requirements become effective for calendar 2013, in line with the tentative ASB proposals, that would probably mean comparatives for the year ending 31 December 2012 with an opening balance sheet as at 1 January 2012. Accordingly, many management and accounting teams may wish to explore the impact IFRS for SMEs will have on their business and results over the coming two years.

To do this, it will be important to

monitor the progress of the ASB's proposals, and the implications of current or planned projects and transactions, such as corporate restructurings and development of shared services centres. It may be necessary to assign responsibility for this to an individual to start to identify issues that will be affected by conversion to IFRS or IFRS for SMEs, including the impact on tax, distributable reserves, bank or loan covenants, contractual arrangements (where they include terms that are based on accounting numbers), management bonus schemes and the commercial implications of increased disclosures where they may be commercially sensitive. As every accountant knows, it is difficult to prepare accounts without making a variety of estimates; estimates about useful lives for depreciation, estimates of the net realisable value of stocks, estimates about bad and doubtful debts, estimates about various provisions, and IFRS for SMEs is rather more demanding than Irish GAAP about providing information in the accounts about critical estimates.

For the majority of Irish companies, the future of financial reporting looks likely to be IFRS for SMEs and, as with any change, adequate planning will be critical to a successful implementation.

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