BY
Robert Kirk

FRS 102 Triennial Amendments applicable 1st January 2019: Part 1

Robert Kirk, CPA, explains the principal amendments to FRS 102 in the first of a series of Accountancy Plus articles.

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 to CPA Members on www.cpaireland.ie.**

In December 2017, the Financial Reporting Council (FRC) published their first set of amendments to the set of local standards established three years ago to replace the former SSAPs and FRSs. This is the first of three articles on the principal changes that will be implemented in January 2019. The revisions cover 192 pages and 673 amendments but the rationale for its excessive length is that there are numerous editorial corrections and minor adjustments which have not changed the fundamentals of the standard and these will not be covered in this short series of articles.

The FRC have decided not to incorporate any elements of the three new IFRSs – IFRS 9 *Financial instruments*, IFRS 15 *Revenue from contracts with customers* and IFRS 16 *Leases* into the revised standard. These will be reviewed when the next triennial review takes place in 2019-20 and will probably be incorporated into FRS 102 *The Financial Reporting Standard applicable to entities in the UK and Republic of Ireland* (FRS 102) at that time. The amendments being introduced in this triennial review have come mainly from feedback from stakeholders to help simplify the standard.

This first article covers a number of principal amendments to FRS 102. The second article in June 2018 will cover further important changes to FRS 102 before completing the series by reviewing the amendments being made to the other FRSs.

The approach adopted by the FRC was to go through FRS 102 and make amendments Section by Section and this is the approach adopted here.

Section 1 Scope

Many of the amendments in Section 1 are caused by the inclusion of specific references to the new legislation in the Republic of Ireland which will enable small entities to apply Section 1A to their financial statements for the first time. However, the disclosure requirements in the ROI are much more extensive than in the UK and that has resulted in the inclusion of additional or separate paragraphs and appendices for the ROI. In addition, since the Companies (Accounting) Act 2017 was passed last year companies in the ROI are entitled to implement both Section 1A of FRS 102 and FRS 105 for accounting periods as from the 1st January 2015, although many of these would already have been published under the old rules.

- Reference is made for the first time to the application of SORPs and the circumstances in which they apply. In addition, reporting entities will be permitted to introduce the changes introduced by the amendments to FRS 102 early as long as all of the proposed amendments are implemented at the same time.
- In all cases, if a reporting entity wishes to apply the amendments early, that fact must be disclosed.
- Changes to accounting policies are to be applied prospectively rather than the normal retrospective approach adopted in international standards. That is to help reduce the costs of transition e.g. companies who identified intangible assets separately from goodwill in a business combination will not subsume them back into goodwill on adoption of the revised standard.
- Reporting entities will be able to adopt their latest fair value as deemed cost if they elect to measure investment property rented to another group instead of at cost.
- Small entities applying Section 1A will now have to provide a compulsory Statement of Compliance with Section 1A of FRS 102 – until now it was merely encouraged.
- If a small entity departs from adopting the going concern concept it must provide disclosure of the rationale for that.
- There are now two appendices (instead of one) for the compulsory notes to be disclosed under Section 1A – Appendix C for the UK and Appendix D for the ROI as there are considerably more disclosures required under ROI legislation and the former optional disclosures in Appendix D are now recorded as Appendix E.
- Although Irish law permits the filing of abridged accounts this is not the same as UK abridged statutory financial statements thus this option has been specifically removed for Irish small entities from Section 1A.

Section 2 Concepts and Pervasive Principles

The conceptual framework is currently being revised by the International Accounting Standards Board (IASB) so there are only a couple of minor changes to Section 2. The amendments clarify that

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investments in ordinary shares and most preference shares should be valued at fair value with adjustments being reported through profit and loss. They are referred to as non-derivative instruments that are the equity of the issuer. It also confirms that the best evidence of fair value is an active market for an identical asset, then the adoption of a past price but only if it is fairly recent, and finally, as a last resort another valuation technique.

Section 3 Financial Statement Presentation

A new section requires that care should be taken over carrying out too much aggregation thereby causing material information to be obscured and thus undermining the understandability of the financial statements. Immaterial notes, however, are not required unless those disclosures are required by legislation.

In addition, under Section 1A, a small entity is exempt from preparing a Statement of Cash Flows. However, that may still be required by the rules in a SORP that the reporting entity may have to comply with.

Section 4 Statement of Financial Position

The amendments remove the need to provide the fairly minor disclosure of a reconciliation of the number of shares outstanding at the beginning and at the end of the year.

Section 5 Statement of Comprehensive Income and Income Statement

The requirement to analyse expenses by either function or nature specifically has been removed as it is argued that they are already required in the formats in company law and this adds duplication. However, an analysis is still required in the income statement or in the notes.

Non-operating profit items must be excluded from 'operating profit' e.g. the profit or loss on discontinued operations. In the Appendix to Section 5, the example has been changed to reflect that approach.

	20X1			20X0		
	Continuing Operations	**Discontinued Operations**	**Total**	Continuing Operations (as restated)	Discontinued Operations (as restated)	Total
	CU	**CU**	**CU**	CU	CU	CU
Turnover	**4,200**	**1,232**	**5,432**	3,201	1,500	4,701
Cost of Sales	**(2,591)**	**(1,104)**	**(3,695)**	(2,281)	(1,430)	(3,711)
Gross Profit	**1,609**	**128**	**1,737**	920	70	990
Administrative Expenses	**(452)**	**(110)**	**(562)**	(418)	(120)	(538)
Other Operating Income	**212**	-	**212**	198	-	198
~~**Profit on Disposal of Operations**~~	-	~~**301**~~	~~**301**~~	-	-	-
Operating Profit	**1,369**	~~**319**~~ **18**	~~**1,688**~~ **1387**	700	(50)	650
Profit on Disposal of Operations	-	301	301	-	-	-
Interest Receivable and Similar Income	**14**	-	**14**	16	-	16
Interest Payable and Similar Charges Expenses	**(208)**	-	**(208)**	(208)	-	(208)
Profit ~~on Ordinary Activities~~ before Tax	**1,175**	**319**	**1,494**	**508**	**(50)**	**458**
Tax~~ation~~ on Profit or Loss	(390)	(4)	(394)	(261)	3	(258)
Profit/(Loss) ~~on Ordinary Activities~~ after Taxation and Profit/(Loss) for the Financial Year	**785**	**315**	**1,100**	**247**	**(47)**	**200**

Section 7 Statement of Cash Flows

No specific reference has been made to either adopting profit before or after tax as the starting point for the indirect method – instead a MEASURE of profit or loss must be adjusted for non-cash transactions, working capital and non-operating income and expenses.

Investing activities now include payments to obtain control and receipts from the disposal of subsidiaries. In addition, foreign subsidiary cash flows should be translated between the group's presentation (and not the functional) currency.

However, the main change is the new requirement to prepare a net debt reconciliation similar to that formerly required by FRS 1 so that the cash flow generated during the period can be reconciled to the net debt on the balance sheet. However, it does not have to be presented according to the format in FRS 1 as long as an analysis of changes in net debt from the beginning to the end of the reporting period is presented showing any changes resulting from:

(a) the cash flows of the entity;
(b) the acquisition and disposal of subsidiaries;
(c) new finance leases entered into;
(d) other non-cash changes; and
(e) the recognition of changes in market value and exchange rate movements.

This analysis is also not required to be presented for prior periods.

Section 9 Consolidated and Separate Financial Statements

The updated rules in IFRS 10 *Consolidated and separate financial statements* on how to identify when one entity controls another have not been incorporated in the amendments. However, this could result in special purpose entities (SPEs) avoiding consolidation so instead additional disclosures are now required in the financial statements regarding the nature and extent of a reporting entity's interests in unconsolidated SPEs and the risks associated with those interests. In addition, revised FRS 102 now states that two or more subsidiaries may only be excluded from consolidation if they are not material when taken together.

Sections 11 and 12 Financial Instruments

There are a number of important changes in this part of the standard as this has created the most criticism from stakeholders.

Adoption of IAS 39 and IFRS 9

If an entity chooses not to apply Section 11 and 12 and instead applies either IAS 39 or IFRS 9, until IAS 39 is superseded by IFRS 9 *Financial Instruments*, reporting entities will still have to apply the version of IAS 39 that is in effect at the entity's reporting date, by reference to the IFRS publication titled *International Financial Reporting Standards IFRS Consolidated without early application.*

When IAS 39 is superseded by IFRS 9, an entity shall apply the version of IAS 39 that applied immediately prior to IFRS 9 superseding IAS 39. A copy of that version will be retained for reference on the FRC website (www.frc.org.uk). Entities must apply the so-called 'EU carve-out of IAS 39', which amended paragraph 81A and related Application Guidance in IAS 39.

Definition of basic financial instrument

FRS 102 has been relaxed in relation to the detailed conditions in paragraph 11.9 of FRS 102 to be defined as a basic financial instrument. Additional paragraphs 11.6a and 11.9a (see below) have introduced a description of a more principles based basic financial instrument to support the detailed conditions and it is hoped that a relatively small number of financial instruments that previously breached the detailed conditions will now qualify as basic and therefore will be measured at amortised cost rather than at fair value.

11.9A A debt instrument not meeting the conditions in paragraph 11.9 shall, nevertheless, be considered a basic financial instrument if it gives rise to cash flows on specified dates that constitute repayment of the principal advanced, together with reasonable compensation for the time value of money, credit risk and other basic lending risks and costs (e.g. liquidity risk, administrative costs associated with holding the instrument and lender's profit margin). Contractual terms that introduce exposure to unrelated risks or volatility (e.g. changes in equity prices or commodity prices) are inconsistent with this.

Director/Shareholders Loans to company

For SMALL ENTITIES ONLY under Section 1A - relief will be provided for loans FROM a director who is a natural person and also a SHAREHOLDER (or a close member of the family of that person) to be accounted for at transaction price rather than at present value. That should alleviate the current problems of loans entered into at below market rates or at zero rates of interest having to be discounted to present value. This change is available for retrospective application from 1st January 2015.

Fair value at initial recognition

Fair value should be adopted as the initial recognition price for a financial instrument under FRS 102 except the following financing transactions may instead be measured initially at transaction price:

(a) a basic financial liability of a small entity that is a loan from a person who is within a director's group of close family members, when that group contains at least one shareholder in the entity; and

(b) a public benefit entity concessionary loan.

Definition of a financial institution

The definition of what constitutes a financial institution has being changed which removes references to 'generate wealth' and 'manage risk'. This should reduce the number of institutions required to provide the enhanced disclosures required under Section 34 of FRS 102.

Removal of retirement benefit plans from definition of financial institution

Retirement benefit plans are also now removed from the list of financial institutions.

The changes being introduced in the first twelve sections are fairly straightforward but the most significant are in relation to financial instruments which have always caused great difficulty for accountants in practice. Hopefully the changes to Director's loans in small entities and the more principles based definition of a basic instrument should help to make the standard more user friendly.

The remaining changes in FRS 102 will be covered in the next issue in June.