

A Comparison of Financial Reporting Standard for Large and Medium Sized Entities and TAS/TFRS

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Extensive Summary

Introduction

Financial Reporting Standard for Large and Medium Sized Entities (FRS for LMEs) was published in Official Gazette on 29 July 2017, effective for annual periods beginning on or after 1 January 2018.

FRS for LMEs establishes the accounting principles to be applied in the preparation of individual and consolidated financial statements of the entities subject to audit other than public interest entities (PIEs) implementing Turkish Accounting Standards (TAS) and Turkish Financial Reporting Standards (TFRS) and their interpretations.

The objective of this study is to examine and explain the rationale behind the issuance and the general features of FRS for LMEs issued in order to provide fair, relevant and comparable information, and make a comparison between the requirements of FRS for LMEs and TAS/TFRS.

Background and Rationale for FRS for LMEs

Public Oversight Accounting and Auditing Standards Authority of Turkey (KGK) was formed in 2011. The accounting and financial reporting requirements of new Turkish Commercial Code effective from 1 January 2013 gives mandate to KGK to issue accounting and financial reporting standards in conformity with IAS/IFRS and to set specific standards for different size entities and industries.

Under these requirements KGK decided that TAS/TFRS should be only mandatory for individual and consolidated financial statements of PIEs for periods beginning on or after 1 January 2014 (Voluntarily application of other entities is permitted.) while TAS/TFRS was mandatory for all entities subject to audit in 2013. Since the size and industries of entities subject to audit are determined by the Decree of Council of Ministers under Turkish Commercial Code, the Council of Ministers set the

limit at TL 200 million net revenue, TL 150 million assets and 500 employees for 2013. As a result, entities meet two of those three criteria was subject to audit. The Council of Ministers lowered those limits in 2014, 2015 and 2016 and are expected to lower for coming years.

Since TAS/IFRS was mandatory for financial statements of PIEs for periods beginning on or after 1 January 2014, KGK decided in 2014 that other entities subject to audit should apply temporarily accounting principles set at General Communiqué on Accounting System Application (MSUGT) published by the Ministry of Finance under Tax Legislation by the time of issuance of a new standard, and started process for establishing a new local financial reporting framework (FRS for LMEs) for entities subject to audit other than PIEs by setting up a study committee composed of the representatives from public, private and professional institutions, other stakeholders, and academicians.

MSUGT applied financial statements would not be applicable financial reporting framework for the audit because of lack of valuation requirements for some items, non-compulsory application of valuation, severance pay, depreciation, rediscount requirements, and because the basic objective was tax reporting. Consequently, they got away from the objective of fair presentation, providing relevant and comparable information. Therefore, KGK temporarily issued further requirements to MSUGT in 2014.

One of the main rationale with FRS for LMEs is to make the financial statements comparable, and by that achieve a fair presentation.

On the other hand, KGK developed FRS for LMEs to meet the users' needs while balancing the costs and benefits to preparers in recognition of the difficulty and cost to entities of preparing fully compliant TAS/IFRS information. It also recognised that users of financial statements have a different focus from those interested in PIEs. Furthermore, they have no public accountability.

European Union (EU) listed entities must prepare their consolidated financial statements in accordance with IFRS. The rules non-listed entities have to follow when preparing financial statements are laid down in directive 2013/34/EU, known as the "accounting directive", effective from 1 January 2016. The objective of this directive is to harmonise national requirements.

Since EU started full membership negotiations with Turkey on 3 October 2004, Turkey should be complying with EU legislation divided into 35 chapters (the "acquis") by the time it joins EU as a full member. Accounting and Auditing subtitle under chapter 6 "Company Law" specifies rules for the presentation of annual and consolidated accounts, including simplified rules for small and medium sized entities. Therefore, the EU acquis is another rationale.

General Features of FRS for LMEs

FRS for LMEs designed to meet the needs and capabilities of Large and Medium Sized Entities (LMEs) subject to audit is a standalone standard of less than 240 pages and 27 chapters and delivers financial statements that provide useful, fair, relevant and comparable information in a simplified, consistent, cost-effective way.

On the other hand, FRS for LMEs, primarily featuring the "Think Small First" principle in EU Accounting Directive, describes the basic concepts that underlie the preparation and presentation of cost based financial statements of medium sized entities and establishes further requirements for large sized entities.

FRS for LMEs written up in a simpler and more comprehensible way compared to TAS/IFRS is in compliance with international financial reporting practices and EU regulations. In the meantime, it has all features of an applicable financial reporting framework for audit and sets up accounting principles. The FRS for LMEs contains simplified accounting rules for entities having no public accountability, and therefore responses all needs of them.

Comparison of FRS for LMEs and TAS/IFRS

This study is for those who wish to gain a broad understanding of the significant differences between FRS for LMEs and TAS/IFRS as well as similarities.

A selection of differences most commonly found in practice are as follows:

- While an entity shall present an analysis of expenses recognised in profit or loss using "function of expense" or "nature of expense" method according to TAS/IFRS, FRS for LMEs uses only "function of expense" method.

- There are two criteria in FRS for LMEs for recognition of revenue: when it is probable that any future economic benefit associated with the item of revenue will flow to the entity, and the amount of revenue can be measured with reliability.

- If the outcome of a construction contract can be estimated reliably, revenue and costs should be recognised in proportion to the stage of completion of contract activity according to FRS for LMEs.

- Biological assets shall be measured at their fair value or cost less costs to sell in TAS/IFRS, it shall be measured at its fair value or cost in FRS for LMEs.

- Measurement after recognition is made on either the cost model or the revaluation model for the exploration and evaluation of mineral resources assets in accordance with TAS/IFRS. FRS for LMEs uses only the cost model.

- Financial instruments are measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss in TAS/IFRS while they are measured as receivables and payables, borrowing instruments, investment in an equity instrument, other financial instruments in FRS for LMEs.

- Intangible assets are amortised in five to ten years in FRS for LMEs.

- There are two broad approaches to the accounting for government grants in TAS/IFRS: the capital approach, and the income approach. The only approach in FRS for LMEs is performance model.

- Goodwill is not tested for impairment and amortized in ten years when the useful life cannot be estimated reliably in FRS for LMEs.

- It is not compulsory for medium sized entities to prepare consolidated annual financial statements in FRS for LMEs while it is compulsory for an entity that is a parent in TAS/IFRS.

Conclusion

Entities subject to audit but applying TAS/TFRS shall apply FRS for LMEs for the annual periods beginning on or after 1 January 2018.

FRS for LMEs delivers comparable financial statements that provide useful, fair, relevant information in a simplified, consistent, cost-effective way.

It is concluded that FRS for LMEs has commonly more simplified requirements even though it is similar in some ways compared to TAS/TFRS.