The IFRS for SMEs

Topic 1.1
Introduction
Michael Wells
Goal of IASB/IFRS Foundation

• To provide the world’s integrating capital markets with a common language for financial reporting
  – in fulfilling this objective, take account of the needs of:
    – small and medium-sized entities; and
    – emerging economies.
Use of IASB’s standards

• Full IFRSs
  – required or permitted for financial reporting
    – listed companies in 122 jurisdictions*
    – unlisted in 93 jurisdictions*

• The *IFRS for SMEs*
  – issued in July 2009
  – About 70 jurisdictions# already permit or require its use or plan to do so in the next 3 years

* Source: www.iasplus.com
# Source: data gathered by IASB staff
Benefits of the *IFRS for SMEs*

- **Improve access to credit**
  - supports lending based on financial statements
  - vendors evaluate finances of buyers
  - foreign loans and suppliers

- **Improve access to equity capital**
  - non-management investors
  - foreign venture capital

- **Education and training**

- **Auditing efficiencies**

- **Ease burden where full IFRSs is required**
Implementation support for the *IFRS for SMEs*

- Released with the *IFRS for SMEs*
  - illustrative financial statements
  - presentation and disclosure checklist
- SME Implementation Group
- *IFRS for SMEs* newsletter
- IFRS Foundation training material
- Facilitate *regional* ‘train the trainers’ workshops organised by others
SME Implementation Group

SMEIG – two responsibilities:

• Consider implementation questions raised by users of the *IFRS for SMEs*. Develop guidance in the form of Q&As (non-mandatory guidance)

• Make recommendations to the IASB on, the need to amend the *IFRS for SMEs*:
  – for implementation issues that cannot be addressed by Q&As; and
  – for new and amended IFRSs that have been adopted since the *IFRS for SMEs* was issued or last amended
Newsletter

• **Monthly IFRS for SMEs Update newsletter**
  – Free subscription delivered by email
    – 4,000 subscribers
  – Topics typically covered:
    – New adoptions and translations
    – SMEIG activity
    – All draft and final Q&As
    – Training material
    – Train the Trainers workshops
    – Staff commentaries
    – Links to resources
IFRS for SMEs training material

• IFRS Foundation does not certify accountants

• Training material developed for use by others
  – developed by IFRS Foundation education staff
  – multi-level peer review
  – not IASB approved

• 35 standalone modules (1 for each section of the IFRS for SMEs)

• Training material = ±2,000 A4 pages
Training material on IFRS for SMEs

Being developed by IFRS Foundation

• One module per Section. To illustrate:

  • Section 17 PP&E is 7 A5 pages long
  • Training module is 32 A4 pages, full text of *IFRS for SMEs* with commentary on each paragraph, many examples, cases, quiz, comparison with full IFRSs, judgements

• Free of charge – download
Propose to development agencies & others

• Fund the official translation of the training material? Response to date:
  – Spanish translation (funded by Spanish government facilitated by World Bank)
  – Russian translation (USAID funding)

• Organise regional ‘train the trainers’ workshops? See next slide for response
  – IFRS Foundation/IASB provides facilitators

• Assist developing nations build sustainable IFRS for SMEs application capacity?
## IFRS Foundation 3-day training workshops

<table>
<thead>
<tr>
<th>Where</th>
<th>Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kuala Lumpur (Jan 2010)</td>
<td>Asia – 11 jurisdictions</td>
</tr>
<tr>
<td>Hyderabad (Jan.)</td>
<td>Asia – 11 jurisdictions</td>
</tr>
<tr>
<td>Dar es Salaam (May)</td>
<td>Africa – 10 jurisdictions</td>
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<tr>
<td>Cairo (June)</td>
<td>Egypt, Lebanon, others</td>
</tr>
<tr>
<td>Rio de Janeiro (August)</td>
<td>Brazil (Portuguese)</td>
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<tr>
<td>Helsinki (Sept. 1½ days)</td>
<td>Nordic/Baltic Countries</td>
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<tr>
<td>Vienna (Sept. 1 day)</td>
<td>REPARIS countries</td>
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<tr>
<td>Panama (October 3½ days)</td>
<td>Latin America (Spanish)</td>
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<tr>
<td>Maputo (December)</td>
<td>Africa (Portuguese)</td>
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<tr>
<td>Kazakhstan (Jan 2011)</td>
<td>Central Asia (Russian)</td>
</tr>
<tr>
<td>Singapore (Jan 2011)</td>
<td>Asia</td>
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</tbody>
</table>
• What we assumed about you
  – you are a trainer in local GAAP
  – you have read the *IFRS for SMEs*
  – you will actively participate in workshop
  – after the workshop you will diligently study all the modules of the IFRS Foundation training material before replicating the training in your country
What you need for each session

- *IFRS for SMEs* (mandatory requirements)
- non-mandatory material accompanying the *IFRS for SMEs*
  - implementation guidance
  - basis for conclusions
- handout
- calculator
- pen and paper
- evaluation form
Free IFRS Foundation/IASB downloads

IFRS for SMEs (full standard, multiple languages):
http://go.ifrs.org/IFRSforSMEs

Training material (English, Spanish and soon Russian):
http://go.ifrs.org/smetraining

PowerPoint Training Modules
(English/Portuguese/Spanish/soon Russian):
http://www.ifrs.org Then click “Get Involved” then “Conferences and Training”

Update Newsletter:
http://www.ifrs.org/IFRS+for+SMEs/

Implementation Group Q&As and proposals:
http://www.ifrs.org/IFRS+for+SMEs/SME+Implementation+Group/SME+Implementation+Group.htm
Topic 1.2
Overview of the *IFRS for SMEs*
Michael Wells

- Review of all sections of the standard
- Highlight key differences with full IFRSs
The *IFRS for SMEs*

Good Financial Reporting Made Simple.

- 230 pages
- Simplified IFRS, but built on an IFRS foundation
- Designed specifically for SMEs
- Internationally recognised
- Tailored for SMEs
  - user needs for cash flow information
  - costs and SME capabilities
Is it stand-alone or linked to full IFRS?

Completely stand-alone

• The only ‘fallback’ option to full IFRS is the option to use IAS 39 instead of the financial instruments sections of *IFRS for SMEs*
Why would an SME want to adopt it?

• Improved access to capital
• Improved comparability
• Improved quality of reporting as compared to existing national GAAP
• Less of a burden where full IFRSs or full national GAAP are now required
• Multinational operations
  – standardised computer systems
  – simplified consolidation procedures
  – standardised training
Plan for maintenance

• Initial comprehensive review after 2 years implementation experience
  – fix errors and omissions, lack of clarity
  – consider need for improvements based on recent IFRSs and amendments to IASs
  – 2014 probably earliest possible effective date of amendments

• Thereafter once every three years (approximately) omnibus exposure draft of updates
Section by section highlights

Selective highlights

• Not complete summaries
• Each section is covered in detail in a separate module of the IFRS Foundation training material (see http://www.iasb.org/IFRS+for+SMEs/Training+material.htm)
Section 1 – Small and medium entities

• Defines SME as used by IASB:
  – not publicly accountable, and
  – publish general purpose financial statements for external users

• Listed companies may not use, no matter how small
Section 2 – Concepts and principles

- Objective of **general purpose** financial statements
- Qualitative characteristics
- Defines asset, liability, equity, income and expenses
- Principles for recognition and measurement
- Guidance if a specific issue is not addressed in the *IFRS for SMEs*
- Principles for offsetting
Section 3 – Financial statement presentation

- Fair presentation: presumed to result if *IFRS for SMEs* is followed (maybe need for supplemental disclosures)
- State compliance with *IFRS for SMEs* only if the financial statements comply in full
- At least one year comparative financial statements and note data
- Defines a complete set of financial statements (see Sections 4 to 8)
Section 4 – Statement of financial position

- May still be called ‘balance sheet’
- Current/non-current split is not required if entity concludes liquidity approach is better
- Some minimum line items
- And some items that may be in the statement or in the notes
- But sequencing, format, and titles are not mandated
Section 5 – Statement of comprehensive income and income statement

• One-statement or two-statement approach
• No ‘extraordinary item’ descriptor
• Must segregate discontinued operations
• Must present profit or loss subtotal if entity has items of other comprehensive income
• Only items of other comprehensive income
  – some foreign exchange gains and losses
  – some changes in fair values of hedging instruments
  – some actuarial gains and losses
Section 6 – Statement of changes in equity

• For each component of equity reconcile opening and closing balance showing:
  – profit or loss
  – each item of OCI
  – transactions with owners in their capacity as owners
    – share issues
    – treasury share transactions
  – dividends and other distributions
  – changes in ownership interests in subsidiaries that do not result in a loss of control
Sections 3 & 6 Restricted option to prepare a statement of income and retained earnings

- Can present SOI&RE in place of statement of comprehensive income and SOCIE if the only changes in equity arise from
  - profit or loss
  - paying dividends
  - retrospective restatement of prior period errors
  - retrospective application for a change of accounting policy
Section 7 – Statement of cash flows

• Option to use the
  – indirect method, or
  – direct method
to present operating cash flows
Section 8 – Notes

• Disclose basis of preparation (ie IFRS for SMEs)
• Summary of significant accounting policies
  – information about judgements
  – information about key sources of estimation uncertainty
• Supporting information for items in financial statements
• Other disclosures
Section 9 – Consolidation

• Consolidation is required when parent-subsidiary relationship except:
  – Sub was acquired with intent to dispose within one year
  – Parent itself is a sub and its parent or ultimate parent uses full IFRSs or IFRS for SMEs

• Basis of consolidation: control
  – Consolidate all controlled SPEs
Section 10 – Accounting policies

• If *IFRS for SMEs* addresses an issue, must follow *IFRS for SMEs*

• Specifies hierarchy to determine accounting policy if *IFRS for SMEs* does not address an issue

• Change in accounting policy:
  – if mandated, follow the transition guidance as mandated
  – if voluntary, retrospective application

• Change in accounting estimate: prospective

• Correction of prior period error: retrospective
Section 11 – Basic financial instruments

• Specifies which financial instruments are basic financial instruments (ie in scope of Section 11)
• Essentially an amortised cost-impairment model
  – except fair value through profit or loss for equity investments with quoted price or whose fair value can otherwise be reliably measured
• Guidance on fair value and effective interest method
• Option to follow IAS 39 instead of Sections 11 & 12
  – when IAS 39 is followed, make Sections 11 & 12 disclosures (not IFRS 7 disclosures)
Section 12 – Other financial instruments

• Financial instruments not covered by Sec 11 are at fair value through profit or loss—including
  – investments in convertible and puttable ordinary and preference shares
  – options, forwards, swaps, and other derivatives
  – financial assets that would otherwise be in Section 11 but that have ‘exotic’ provisions that could cause gain/loss to the holder or issuer

• Hedge accounting
Section 13 – Inventories

• Measure at lower of
  – cost
  – estimated selling price less costs to complete and sell

• Cost may be
  – specific identification in specified cases, eg if items are not ordinarily interchangeable
  – FIFO or weighted average for others
Section 14 – Associates

• Option to use:
  – Cost model (except if published quotation then must use fair value through profit and loss)
  – Equity method
  – Fair value through profit or loss (if impracticable, then use cost)

Cost and FV models are not allowed by IAS 28
Section 15 – Joint ventures

• Option to use:
  – Cost model (except if published quotation then must use fair value through profit and loss)
  – Equity method
  – Fair value through profit or loss (if impracticable, then use cost)

• Proportionate consolidation is prohibited

Cost and FV models are not allowed by IAS 31. Proportionate consol is allowed by IAS 31.
Section 16 – Investment property

• If fair value can be measured reliably without undue cost or effort on an ongoing basis, use fair value through profit and loss
• Otherwise, must treat investment property as property, plant and equipment using Section 17

IAS 40 accounting policy choice—either cost–depreciation–impairment model or fair value through profit and loss
Section 17 – Property, plant & equipment

• Historical cost–depreciation–impairment model
• Component depreciation for major parts of an item of PP&E that have ‘significantly different patterns of consumption of economic benefits’
• Review useful life, residual value, depreciation rate only if there is a significant change in the asset or how it is used
• Impairment testing (see Section 27)

Revaluation model is permitted by IAS 16
Section 18 Intangibles other than goodwill

- Historical cost–depreciation–impairment model
- No recognition of internally generated intangible assets
- Amortise intangibles that are purchased separately, acquired in a business combination, acquired by grant, acquired by exchange of other assets
- Amortise over useful life. If unable to estimate useful life, then use 10 years
- Impairment testing (see Section 27)

IAS 38 permits revaluation of some intangibles and prohibits amortising indefinite-life intangibles
Section 19 – Business combinations and goodwill

• Acquisition method
• Amortise goodwill. If unable to estimate useful life, then use 10 years.
• Impairment testing (see Section 27)
• Negative goodwill—first reassess original accounting. If that is ok, then immediate credit to profit and loss

Goodwill amortisation is prohibited by IAS 38
Section 20 – Leases

• Classification—finance or operating lease
• Measure finance leases at lower of FV of interest in leased property and present value of minimum lease payments
• For operating leases, do not force straight-line expense recognition if lease payments are structured to compensate lessor for general inflation
Section 21 – Provisions & contingencies

• Recognise obligation arising from a past event that can be estimated reliably
• Disclose (no recognition) contingent liability
• Measure at best estimate
  – large population – weighted average calculation
  – single obligation – adjusted most likely outcome
• Includes an appendix of examples
Section 22 – Liabilities and equity

• Guidance on classifying an instrument as liability or equity
  – instrument is a liability if the issuer could be required to pay cash
  – however, if puttable only on liquidation then it is equity
Section 23 – Revenue

• Same principles as IAS 18 and IAS 11
  – Goods: Revenue recognised when risks and rewards are transferred, seller has no continuing involvement, measurable
  – Services and construction contracts: Recognise by percentage of completion

• Principle for measurement is fair value of consideration received or receivable
Section 24 – Government grants

- All measured at the fair value of the asset received or receivable
- Recognition as income
  - immediately if no performance conditions are imposed
  - if conditions, recognise when conditions are fulfilled

IAS 20 allows a wide range of methods of accounting for government grants.
Section 25 – Borrowing costs

• All charged to expense when incurred

IAS 23 requires capitalisation of borrowing costs relating to an asset during construction
Section 26 – Share-based payment

- Must recognise
- Measure at fair value if practicable
- If it is impracticable to determine the fair value of the option or other instrument granted, the entity’s directors should use their judgement to apply the most appropriate valuation method

IFRS 2 has intrinsic value ‘simplification’
Section 27 – Impairment of assets

- **Inventories** – lower of cost and selling price less costs to complete and sell
- **Other assets** – write down to recoverable amount, if below carrying amount
- **Recoverable amount** = greater of fair value less costs to sell and value in use
- **Section 27 does not cover specified assets**
  - eg deferred tax, employee benefits, financial assets in Sec’s 11 and 12, investment property & biological assets carried at fair value
Section 28 – Employee benefits

• Recognise cost of EBs to which employees have become entitled for service rendered to entity in reporting period
  – liability, after deducting amounts that have been paid. Asset if prepaid EB expense
  – expense, unless another section requires cost included in asset (for example inventories or PP&E)
Section 29 – Income tax

Steps in accounting for income tax:
1. Recognise current tax
2. Identify which assets and liabilities would affect taxable profit if recovered or settled for their carrying amounts
3. Determine tax basis of items in (2) plus other items that have a tax basis although not recognised (eg borrowing cost or R&D that is capitalised for tax purposes)
4. Compute temporary differences, unused tax losses, unused tax credits
5. Recognise deferred tax assets or liabilities arising from temporary differences
6. Measure deferred tax assets and liabilities
   – use substantively enacted tax rates
   – consider possible outcomes of a review by tax authorities
7. Valuation allowance against deferred tax assets (probable recovery)
8. Allocate current and deferred tax to related components of profit and loss, OCI, equity
Section 30 – Foreign currency translation

Section 30 prescribes how to
– determine an entity’s functional currency
– measure foreign currency transactions
– include foreign operations in financials
– translate into a presentation currency

It also specifies disclosures.
Section 31 – Hyperinflation

• An entity must prepare general price-level adjusted financial statements when its functional currency is hyperinflationary
  – Approximately greater than 100% over three years
Section 32 – Events after the end of the reporting period

Two types of events after the end of the reporting period

- **adjusting events**—those that provide evidence of conditions that existed at the end of the reporting period
- **non-adjusting events**—those that are indicative of conditions that arose after the end of the reporting period
  - no recognition but disclose
Section 33 – Related party transactions

FS include disclosures necessary to draw attention to the possibility that an entity’s financial position and performance have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

Assess the substance of the relationship and not merely its legal form.
Section 34 – Specialised activities

- Agriculture – use fair value if readily determinable without undue cost or effort otherwise use historical cost model
- Extractive activities
- Service concession arrangements
Section 35 – First-time adoption

• Prepare current year and one prior year's financial statements using the IFRS for SMEs
• But there are many exemptions for restating specific items
• And a general exemption for impracticability
Expressions of individual views by members of the IASB and its staff are encouraged.

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