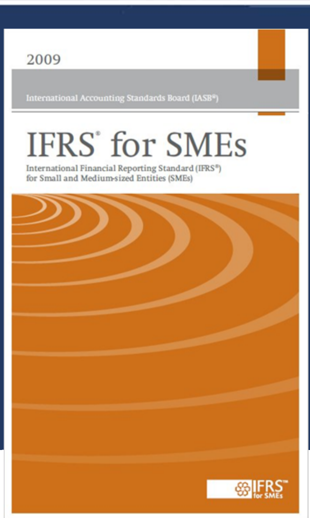
International Financial Reporting Standards




# A Closer Look at the IFRS for SMEs

Paul Pacter, IASB
Board Member (Designate)

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## The IFRS for SMEs

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**Good Financial Reporting Made Simple.**

- 230 pages
- Simplified IFRSs, but built on an IFRS foundation
- Completely stand-alone
- Designed specifically for SMEs
- Internationally recognised
- Final standard issued 9 July 2009

## Who is eligible to use it?

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**Any entity that does not have public accountability...**

- securities not publicly traded
- not a financial institution

**... and is required or chooses to produce General Purpose Financial Statements (GPFS)**

## Who is the standard aimed at?

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**Which entities must produce GPFS is a public interest issue**

- Decided by parliaments and regulators, not by IASB
- Why? There is a public benefit in good financial information about companies

## Who is the standard aimed at?

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### Millions of companies (over 99%)!

- The 52 largest stock exchanges in the world together have only around 45,000 listed companies globally
- Europe has roughly 25 million private sector enterprises
- USA has roughly 20 million private sector enterprises
- UK alone has 4.7 million private sector enterprises

–99.6% have fewer than 100 employees

## Is it stand-alone or linked to full IFRS?

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### 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

## How does it differ from full IFRSs?

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- **Tailored for SMEs**
  – User needs for information about cash flows, liquidity, and solvency
  – Costs and SME capabilities
- **Much smaller**
  – 230 pages vs 3,000 in full IFRSs
- **Organised by topic**
- **Simplifications** from full IFRSs

## How did we simplify?

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1. Some topics in IFRSs omitted if irrelevant to private entities
2. Where IFRSs have options, include only simpler option
3. Recognition and measurement simplifications
4. Reduced disclosures
5. Simplified drafting

## Disclosure simplifications



- **Big reduction in disclosures:**
  - Full IFRSs – more than 3,000 items in the disclosure checklist
  - IFRS for SMEs – roughly 300 disclosures

**Kept: Disclosures about short-term cash flow, liquidity, solvency, measurement uncertainties, accounting policy choices**

**Dropped: Disaggregations, public capital market disclosures**

## Why would an SME want to adopt it?



- **Improved access to capital**
  - This is the #1 issue with SMEs
- **Improved comparability**
- **Improved quality of reporting** as compared to existing national GAAP
  - World Bank ROSC reports
- **Less of a burden** for entities in jurisdictions where full IFRSs or full national GAAP are now required.

## Why would an SME want to adopt it?

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- **Other benefits:**
  - Implementation Q&As – new IASB SME Implementation Group
  - Special newsletter for SMEs and auditors using the IFRS for SMEs
  - Textbooks available
  - Software available
  - IASB training materials (already posted)
  - Commercial training programmes

## There's a payback for good accounting

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**"Transparency, Ownership, and Financing Constraints in Private Firms" (Hope, Thomas, and Vyas), November 2009**

•**Study:** Around 31,000 SMEs in 68 developing countries and emerging markets

•**Abstract:** **We find that private firms with greater financial transparency experience significantly lower problems with gaining access to external finance (and obtain those funds at a lower cost) than do other private firms.**

## There's a payback for good accounting

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**"Financial Reporting Quality and Investment Efficiency of Private Firms in Emerging Markets" (Chen, Hope, and Li, November 2009)**

•**Study:** Around 7,000 SMEs in 20 emerging markets

•**Abstract:** **We find strong evidence that accounting quality positively affects investment efficiency** (i.e., is negatively related to both underinvestment and overinvestment) for our sample of relatively small private firms in lower-income countries.

## Can SMEs simply choose to adopt it?

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**Depends on local law**

- USA – yes. IASB is now the second designated standard setter (along with FASB) in the AICPA code of ethics.
- Other countries, adoption is "automatic" (law already requires "IFRS")
- In some countries, however, currently only full IFRSs and local GAAP can be used. Need to change local law or regs to permit adoption of the IFRS for SMEs.

## Jurisdiction plans for adoption

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**Today (June 2010), to the best of our knowledge:**

– 62 jurisdictions have either adopted the IFRS for SMEs or stated a plan to adopt it within the next three years

## Jurisdiction plans for adoption

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**Some examples (please remember that the IFRS for SMEs was issued less than a year ago):**

- **South America adoptions:** Argentina (proposal), Brazil, Venezuela
- **Caribbean adoptions:** Dominican Republic, Guyana, Barbados, Trinidad, Bahamas, etc
- **Central America adoptions:** Belize, Costa Rica, El Salvador, Panama, Nicaragua
- **Africa adoptions:** South Africa, Botswana, Egypt (proposal), Namibia, Tanzania, Uganda, Ethiopia, Sierra Leone

## Jurisdiction plans for adoption

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**Adoption examples, continued:**

- **Asian adoptions:** Cambodia, Philippines, Hong Kong, Malaysia (proposal). Singapore studying.
- **Europe adoptions:** United Kingdom (proposed), Ireland (proposed), Turkey. Others studying. Note that European Commission is currently consulting on the IFRS for SMEs.
- **Available for use without any action:** United States, Australia, Canada (but Canada has also adopted its own SME standard, and Australia is considering disclosure exemptions only)

## What would the audit report say?

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- **Something like:**

  "Fairly presents financial position, results of operations, and cash flows in conformity with the International Financial Reporting Standards for Small and Medium-sized Entities"

## Plan for maintenance

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**Initial comprehensive review after 2 years implementation experience**

- Fix errors and omissions, lack of clarity
- Also consider need for improvements based on recent IFRSs and amendments to IASs

**Thereafter once every three years**

- (approximately) Omnibus exposure draft of updates

## Plan for maintenance

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**Estimate of initial update:**

–2010 and 2011 first two years of experience

–2012 begin review

- – Both implementation problems and consider changes to full IFRSs
- – Invitation to comment 2012
- – Exposure Draft 2012 or 2013
- – Final amendments 2013

–2014 earliest possible effective date of amendments

- – **So, 4-5 year "stable platform"**

## Translations

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- **Complete or nearly complete:**
  - Chinese, Spanish, Italian, Portuguese, Romanian
- **In process:**
  - Arabic, Czech, French, Japanese, Serbian, Turkish
- **Proposed or in discussion:**
  - Armenian, Khmer, Macedonian, Polish, Russian, Ukrainian

## IASCF training materials for SMEs

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**Being developed by IASC 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**
- 19 modules now posted. Rest in 2010.
- English. Other languages (funding).
- Free of charge – download

## IASCF 3-day training workshops

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### "Train the trainers"

- Regional group or development agency organises
- IASCF/IASB provides trainers and materials (no charge, just pay travel expenses)
- 3 days, intensive study, most sections of IFRS for SMEs
- Participants must commit to study the training materials and do training in their home country
- Instruction in English (also plan Spanish, Portuguese and others)

## IASCF 3-day training workshops

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### "Train the trainers" workshops:

| Where | Participants |
|---|---|
| Kuala Lumpur (Jan 2010) | Asia – 11 jurisdictions |
| Hyderabad (Jan.) | Asia – 11 jurisdictions |
| Dar es Salaam (May) | Africa – 10 jurisdictions |
| Cairo (June) | Egypt, Lebanon, others |
| Helsinki (Sept. 1½ days) | 5 Nordic Countries |
| Rio de Janeiro (August) | Brazil and others |
| Panama (October) | All Central America |

**Several others in planning stages**

## SME Implementation Group

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### SMEIG being formed – 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

## New IASB SME Newsletter

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### *IFRS for SMEs Update*:

•Launched March 2010

•Four issues already published

•Monthly

•Free subscription via email

•Staff summary of news relating to IFRS for SMEs

## Free downloads from IASB

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**IFRS for SMEs (full standard, multiple languages):**

http://go.iasb.org/IFRSforSMEs

**Training materials (35 modules):**

http://go.iasb.org/smetraining

**PowerPoint Training Modules (20 modules, total 24 hours training):**

http://www.iasb.org Then click “Get Involved” then “Conferences and Training”

**IFRS for SMEs Update Newsletters:**

http://www.iasb.org/IFRS+for+SMEs/

## Section by section highlights

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**The next 45 or so slides highlight the requirements of the 35 sections of the IFRS for SMEs**

- These are selective highlights
- Not complete summaries

## Section 1  Small and medium entities

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- 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

30

- Objective: Information about financial position, performance, cash flows
  - Also shows results of stewardship of management over resources
- Qualitative characteristics — relevance, reliability, etc
- Defines asset, liability, equity
- Defines income and expenses

## Section 2 Concepts and principles

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- Basic recognition concepts
- Basic measurement concepts
- Pervasive recognition and measurement principles
  - Source of guidance if a specific issue is not addressed in the IFRS for SMEs
- Concepts of profit or loss and total comprehensive income
- Principles for offsetting

## Section 3 Financial statement presentation

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- 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

## Section 3 Financial statement presentation

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- Complete set of financial statements:
  - Statement of financial position
  - Either single statement of comprehensive income, or two statements: Income statement and statement of comprehensive income
  - Statement of changes in equity
  - Statement of cash flows
  - Notes

## Section 3 Financial statement presentation

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Single ***Statement of Comprehensive Income***:

- Revenue
- Expenses:
  - Finance costs
  - P&L from associates / JVs
  - Tax expense
  - Discontinued operations
- Profit or loss
- Items of Other Comprehensive Income
- Total comprehensive income

**Two statements:**

***Income Statement:***

- Bottom line is profit or loss (as at left)

***Statement of Compre-hensive Income:***

- Begins with profit or loss
- Items of OCI
- Bottom line is Total Comprehensive Income

## Section 3 Financial statement presentation

35

- Can present only an income statement (no statement of comprehensive income) if no items of other comprehensive income (OCI)
- The only OCI items under IFRS for SMEs are:
  - Some foreign exchange gains and losses
  - Some changes in fair values of hedging instruments
  - Some actuarial gains and losses

## Section 4 Statement of financial position

36

- 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

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- One-statement or two-statement approach
- Must segregate discontinued operations
- Must present "profit or loss" subtotal if entity has items of other comprehensive income

**IASB has agreed to drop the two-statement approach in full IFRSs.**

## Section 5 Statement of Comprehensive Income and Income Statement

38

- If an SME presents consolidated financial statements:
  - Bottom line (Profit or Loss in the income statement and Total Comprehensive Income in the statement of comprehensive income) is before allocating those amounts to non-controlling interest and owners of the parent

## Section 6 Statement of Changes in Equity

39

- Shows all changes to equity including
  - total comprehensive income
  - owners investments and withdrawals
  - dividends
  - treasury share transactions
- Can omit if no owner investments or withdrawals other than dividends

## Section 7 Statement of cash flows

40

- All SMEs must present a statement of cash flows
- Option to use the
  - indirect method, or
  - direct method

  to present operating cash flows

## Section 8 Notes

41

- 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

42

- 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

43

- If IFRS for SMEs addresses an issue, must follow IFRS for SMEs
- If IFRS for SMEs does not address an issue:
  - Choose policy that results in most relevant and reliable information
  - Try to analogise from requirements in the IFRS for SMEs
  - Or use concepts/pervasive principles in Sec 2
  - May look to guidance in full IFRSs — but not required

## Section 10 Accounting policies

44

- Change in accounting policy:
  - If mandated, follow the transition guidance as mandated
  - If voluntary, retrospective
- Change in accounting estimate: prospective
- Correction of prior period error: restate prior periods if practicable

## Section 11 Basic financial instruments

45

- Section 11 is an amortised historical cost model with one exception:
  - Equity investments with quoted price or readily determinable fair value are at fair value through P&L
- Option to follow IAS 39 instead of sections 11 and 12
  - Even if IAS 39 is followed, make Section 11/12 disclosures (not IFRS 7 disclosures)

## Section 11 Basic financial instruments

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- Scope of Sec 11 includes:
  - Cash
  - Demand and fixed deposits
  - Commercial paper and bills
  - Accounts and notes receivable and payable
  - Debt instruments where returns to the holder are fixed or referenced to an observable rate
  - Investments in non-convertible and non-puttable ordinary and preference shares
  - Most commitments to receive a loan

## Section 11 Basic financial instruments

47

- Amortised cost – effective interest method
- Must test all amortised cost instruments for impairment
- Reversal of impairment
- Guidance on fair value and effective interest method
- Derecognition

**Criteria for basic instruments similar to IFRS 9.**
**No HTM or AFS – same as IFRS 9.**

## Section 12 Complex financial instruments

48

- Financial instruments not covered by Section 11 are at fair value through profit or loss. This includes:
  - 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

49

- At cost, which may be
  - specific identification for specialised items
  - FIFO or weighted average for others
- Impairment (write down to estimated selling price less costs to complete and sell)

## Section 14 Associates

50

- Option to use:
  - Cost model (except if published quotation then must use Fair Value through P&L)
  - Equity method
  - Fair value through profit or loss loss (if impracticable, then use cost)

**Cost and FV models are not allowed by IAS 28.**

## Section 15 Joint ventures

51

- Option to use:
  - Cost model (except if published quotation then must use Fair Value through P&L)
  - 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

52

- If fair value can be measured reliably without undue cost or effort, use Fair Value through P&L
- Otherwise, must treat investment property as property, plant and equipment using Section 17

**IAS 40 is pure accounting policy choice – either depreciation model or fair value through P&L.**

## Section 17 Property, plant & equipment

53

- Historical cost – depreciation – impairment model only. No revaluation model.

**IAS 16 allows reval of PP&E through equity.**

- Section 17 applies to investment property if fair value cannot be measured reliably
- Section 17 applies to property held for sale
  - Holding for sale is an impairment indicator

**IFRS 5 requires separate treatment for non-current assets held for sale**

## Section 17 Property, plant & equipment

54

- Component depreciation only if major parts of an item of PP&E 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

**IAS 16 requires annual review**

- Impairment testing and reversal – follow Section 27

## Section 18 Intangibles other than goodwill

55

- No recognition of internally generated intangible assets

**IAS 38 requires capitalisation of development costs incurred after a determination of commercial viability**

## Section 18 Intangibles other than goodwill

56

- Amortise intangibles that are purchased separately, acquired in a business combination, acquired by grant, and acquired by exchange of other assets
- Amortise over useful life. If unable to estimate useful life, then use 10 years
- Impairment testing – follow Section 27

## Section 19 Business combinations & goodwill

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- Acquisition method
- Amortise goodwill. If unable to estimate useful life, then use 10 years.
- Impairment testing and reversal – follow Section 27
- Negative goodwill – first reassess original accounting. If that is ok, then immediate credit to P&L

**Goodwill amortisation is prohibited by IAS 38.**

## Section 20 Leases

58

- Finance and operating lease classification similar to IAS 17
- 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

**IAS 17 requires straight-line recognition.**

## Section 21 Provisions & contingencies

59

- Accrue if an obligation arising from a past event and amount can be estimated reliably
- Disclose (no accrual) 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

60

- 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 22 Liabilities and equity

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- Section 22 also covers:
  - original issuance of shares and other equity instruments
  - sales of options, rights and warrants
  - stock dividends and stock splits

**These topics are not addressed in full IFRSs.**

## Section 23 Revenue

62

- 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

63

- 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

64

- All charged to expense when incurred
- No capitalisation

**IAS 23 requires capitalisation of borrowing costs relating to an asset during construction.**

## Section 26 Share-based payment

65

- 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

66

- Inventories - write down to lower of cost and selling price less costs to complete and sell, if below carrying amount
- Other assets - write down to recoverable amount, if below carrying amount
- Recoverable amount is the greater of fair value less costs to sell and value in use

## Section 28 Employee benefits

67

- For defined benefit plans, use projected unit credit calculation only if entity is able without undue cost or effort. Otherwise, can simplify:
  - Ignore estimated future salary increases
  - Ignore future service of current employees (assume closure of plan)
  - Ignore possible future in-service mortality

**These simplifications are not in IAS 19.**

## Section 28 Employee benefits

68

- Actuarial gains and losses may be recognised in profit or loss or as an item of other comprehensive income
  - No deferral, including no corridor approach

**IAS 19 allows various options for deferring and amortising actuarial gains and losses – though IASB has proposed to eliminate those options**

## Section 29 Income tax



- Recognise deferred taxes if the tax basis of an asset or liability is different from its carrying amount
  - Temporary difference approach
- Tax basis assumes recovery by sale. (If zero capital gains tax, no deferred tax)
- No deferred tax on an asset or liability if recovery or settlement of carrying amount is not expected to affect taxable profit

## Section 29 Income tax



- Exception: No deferred tax on unremitted earnings of foreign subsidiaries and JVs
- Recognise deferred tax assets in full, with valuation allowance
  - Criterion is that realisation is probable (more likely than not)
- Deferred taxes all non-current

**Section 29 model is same as IASB/FASB March 2009 exposure draft on Income Tax**

## Section 30 Foreign currency translation

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- Functional currency approach similar to that in IAS 21
- No recycling of gains or losses on net investment in a foreign entity that are initially recognised in other comprehensive income

## Section 31 Hyperinflation

72

- 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 End of Reporting Period

73

- Adjust financial statements for events after the balance sheet date that provide further evidence of conditions that existed at the end of the reporting period
- Do not adjust for events or conditions that arose after the end of the reporting period
- Dividends declared after end of period are not a liability

## Section 33 Related party disclosures

74

- Government departments and agencies are not related parties simply by virtue of their normal dealings with an entity
- Disclosure of key management personnel compensation only as one number in total
- Fewer disclosures about transactions

## Section 34 Specialised activities

75

- Agriculture – use historical cost model unless fair value is readily determinable without undue cost or effort
- Oil and gas and mining – not required to charge exploration costs to expense

## Section 35 First-time adoption

76

- 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

## No sections covering these topics

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- Segment reporting
- Earnings per share
- Interim reporting
- Assets held for sale

## Questions or comments?

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Expressions of individual views by members of the IASB and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.