



IFRS for SMEs

It's been six years in the making but the IASB's IFRS for SMEs (Small and Medium-sized Entities) is finally here. **Fiona Hackett** takes a look at the final standard.

The standard is the product of a long and challenging development process which saw the IASB (International Accounting Standards Board) receive 162 comment letters in response to its Exposure Draft, conduct extensive 'field testing' with the assistance of a number of private entities worldwide, hold a number of public round-table meetings and engage in numerous debates about the content of the final standard.

Enjoy the little things in life

The IFRS for SMEs is a self-contained standard containing recognition, measurement, presentation and disclosure requirements for all entities in its scope. The entire standard runs to about 300 pages, compared to about 3,000 pages in full IFRS!

A number of topics in full IFRS that are not considered to be relevant to SMEs have been omitted, e.g. there is no guidance on operating segments or earnings per share. A number of full IFRS accounting policy options have been removed, with only one option allowed in the IFRS for SMEs, e.g. there is no option to carry property, plant and equipment at valuation. One of the big attractions of the standard is the significantly reduced disclosure requirements compared to full IFRS. The disclosure requirements of the IFRS for SME are potentially 15-20% of those in full IFRS.

What is in a name?

The standard is intended to apply to entities that:

- Do not have public accountability; and
- Publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

The IASB have defined "public accountability" as;

"Accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular needs."

An entity is deemed to have "public accountability" if;

- It has debt or equity instruments traded in a public market,
- It is in the process of issuing debt or equity instruments for trading in a public market, or
- It holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses, e.g. banks, credit unions, insurance companies, investment banks and mutual funds.

The title of the IASB's standard does not tell the full story of the number of entities that would fall into the scope of this standard. Private companies with multi-billion Euro balance sheets that aren't publicly accountable would fall into the scope of this standard.

The Future of UK and Irish GAAP?

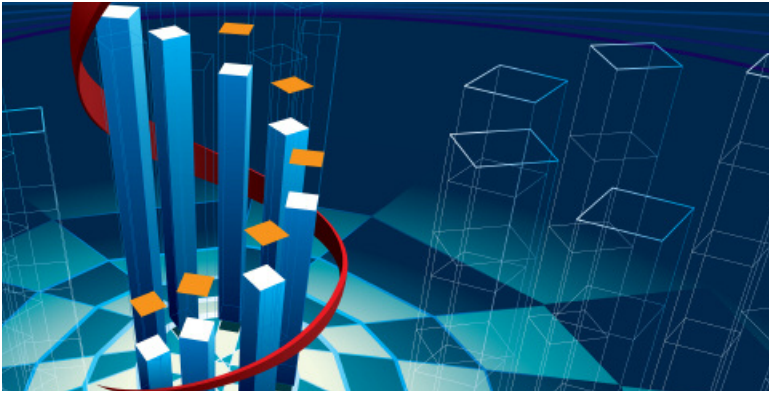
The publication of this standard is a commendable achievement for the IASB. However, publication of the IFRS for SMEs also represents a red letter day in the determination of the future of UK and Irish GAAP. Recent indications from the UK Accounting Standards Board (ASB) are that it plans to propose a three tier reporting structure as the future of UK and Irish GAAP. The ASB have indicated that the three tiers would be as follows;

Tier	Accounting Regime	Type/Nature of Entities	Implications For
One	Full IFRS (EU adopted)	Publicly Accountable Entities	EU listed – consolidated AIM listed Investment Trust Entities Friendly societies Subsidiaries with listed debt
Two	IFRS for SMEs	Large and Medium NPAEs (Non-Publicly Accountable Entities)	NPA groups NPA entities NPA subsidiaries
Three	FRSSE (ASB's Financial Reporting Standard for Smaller Entities)	Small Entities that are not Publicly Accountable	

The ASB plan have issued a consultation paper on the proposed three tier structure. The current proposals would mean that UK and Irish GAAP as we currently know it would cease to exist and be replaced by the IFRS for SMEs for a large number of private entities. Indications from the ASB are that the three tier reporting structure could be effective by 2013.

The ASB's proposals could also mean that a number of private companies that meet the definition of publicly accountable are faced with transitioning their financial statements to full IFRS. The proposed structure means that there is no size limit on the definition of "public accountability", therefore a number of companies such as credit unions and investments funds that would currently meet the definition of small or medium sized within companies legislation would have to prepare financial statements in accordance with full IFRS.

Within the three tier structure entities would have the option to 'opt-up' a level. Tier three entities could elect to prepare their financial statements using FRSSE, IFRS for SMEs or full IFRS. Tier two entities could elect to prepare their financial statements using IFRS for SMEs or full IFRS.



Big Brother's Little Brother

It is important to remember that the IFRS for SMEs is an IASB standard, built on the principles and fundamentals of full IFRS, and is therefore closer to full IFRS than UK and Irish GAAP. The IFRS for SMEs is written using IFRS language, e.g. it discusses inventory instead of stock, and property plant and equipment instead of tangible fixed assets.

Differences to UK and Irish GAAP

Preparing financial statements in accordance with IFRS for SMEs would see a significant number of UK and Irish entities coming to terms with a very different 'look and feel' for their financial statements. There are also a number of areas where measurement principles under IFRS for SMEs are very different to UK and Irish GAAP. Some areas where differences may arise are discussed in more detail below.

Cash Flow Statements

Under IFRS for SMEs a complete set of financial statements will include a statement of cash flows. A number of UK and Irish entities currently avail of an exemption from preparing a cash flow statement as they are included in consolidated financial statements of a parent that are publicly available.

Financial Instruments

Where an entity has complex financial instruments, such as derivative financial instruments, under IFRS for SMEs they would be required to recognise such instruments at fair value with changes generally recognised in profit or loss. This would represent a significant change for entities that currently do not have to apply the provisions of FRS 26, Financial Instruments: Recognition and Measurement.

Fair value through profit or loss

IFRS for SMEs allows or requires much greater use of 'fair value through profit or loss', than UK and Irish GAAP. Derivative financial instruments, investment property, biological assets and investments in listed shares are generally required to be accounted for at fair value through profit or loss. IFRS for SMEs also introduces the option to account for investments in associates or joint ventures at fair value through profit or loss.

The usual suspects

A number of measurement differences compared to UK and Irish GAAP also exist in the following areas;

- Income taxes – IFRS for SMEs employs a balance sheet methodology to calculating deferred tax, which is a conceptually different methodology to FRS 19, Deferred Tax.
- Business combinations – under IFRS for SME the purchase method of accounting is used to account for all business combinations in scope – there is therefore no concept of merger accounting, as there is under FRS 6, Acquisitions and Mergers.
- Intangible assets and goodwill – the definition of an 'intangible asset' under IFRS for SME should lead to a greater number of intangible assets being recognised in business combinations, when compared to accounting for acquisitions under UK and Irish GAAP. Such intangible assets would include customer relationships and customer contracts.
- Employee benefits – IFRS for SMEs gives entities an accounting policy choice in relation to accounting for actuarial gains and losses in defined benefit pension schemes; such gains and losses can be recognised in profit or loss or in other comprehensive income (equivalent to the STRGL under UK and Irish GAAP).

New Disclosures

IFRS for SMEs would also introduce a number of new and detailed disclosure requirements for UK and Irish entities.

- Related party disclosures – there are no exemptions from disclosing transactions with other group companies under IFRS for SMEs, unlike FRS 8, Related Party Disclosures, which provides exemptions in certain situations.
- Information about judgements and sources of estimation uncertainty – IFRS for SMEs introduces a requirement to disclose information about significant judgements made by management in applying an entity's accounting policies and information about the key assumptions concerning the future, and other key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Have your say on the future of UK and Irish GAAP

With the issue of their consultation paper of the future of UK and Irish GAAP due shortly it is timely for entities to consider how the proposals will impact on their reporting requirements. A number of industry sectors and entities would be significantly affected if the proposals were to become mandatory. Are you one of them? Now is your chance to have your say on the future of UK and Irish GAAP.

Biography

Fiona Hackett works for PricewaterhouseCoopers and is a Senior Manager in their Accounting Consulting Services department.