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Partners for success

ICPAK Financial Reporting Workshop

IFRS for SMEs – an Overview

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Agenda

- What is it and who can apply it?
- How does IFRS for SMEs differ?
  - Features
  - Simplifications
- Transition
- Q & As issued

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Background

What is it?

What is the IFRS for SMEs?

Good financial reporting made simple:

- 230 pages – stand alone
- Simplified IFRS, but built on IFRS foundation
- Designed for SMEs
- Internationally recognised

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What is an SME?

An SME is defined as an entity:

- That does not have public accountability;
- That publishes general purpose financial statements for external users (e.g. owners not involved in day to day management, Kenya Revenue Authority, existing and potential creditors, credit rating agencies);
- Whose debt and equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market); and
- That does not hold funds in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

What is not an SME?

In the context of Kenya, ICPAK has designated the following entities as publicly accountable, which therefore cannot use IFRS for SMEs as a framework for external reporting:

- Companies whose debt or equity instruments are traded in a public market or are in the process of issuing such instruments for trading in a public market
- Banks and building societies
- Savings and credit unions including SACCOs
- Insurance companies
- Retirement benefit schemes
- State owned entities including state funded parastatals
- Mutual funds
- Investment banks
- Stock brokers

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Subsidiaries of listed companies …

… that are themselves NPA could choose to comply with IFRS for SMEs, BUT:

- Recognition and measurement under IFRS for SMEs and full IFRS are different
- Adjustments may be necessary on consolidation
- Parents may want their subsidiaries to comply with full IFRS
- No cherry picking between the two allowed

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Effective date in Kenya

- 5 October 2009

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Organisation of the IFRS

- IFRS for SMEs - 230 pages
- Basis for Conclusion - 52 pages
- Illustrative Financial Statements – 17 pages
- Presentation and Disclosure Checklist - 41 pages
- IFRS for SMEs Fact Sheet - 6 pages

Framework, and principles and mandatory guidance in existing IFRS used as a starting point

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Training modules

- 23 modules released as at 30 June 2011
  - Include: requirements, examples, case studies, quizzes, comparison with full IFRS, discussion of estimates and judgements

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Maintenance

- Through review of SMEs' experience in applying the IFRS after 2 years of use by a broad range of users. New and amended IFRSs that have been adopted will also be considered
- Omnibus exposure drafts approximately every three years
- One year between the time amendments are issued and their effective date
- Not affected by changes in full IFRS until IFRS for SMEs are amended

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How does IFRS for SMEs differ from full IFRS?

The bad news is …

- Revaluations of property, plant and equipment prohibited
- No capitalisation of borrowing costs
- Deferred tax still has to be accounted for
- Consolidation still required

But the good news is …

- Revaluation of PPE prohibited
- Two categories of financial assets (amortised cost and fair value through profit or loss) - no more AFS and HTM
- Simpler options allowed when compliance with benchmark would involve “undue cost or effort”, e.g. for retirement benefit obligations and biological assets
- No IFRS 7 disclosures

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Simplifications from full IFRS

- Omitted topics
- Options excluded
- Recognition and measurement simplifications
- Substantially reduced disclosure requirements
- ‘Clarity’ redrafting

Omitted topics

- Topics applicable to listed companies:
  - Earnings per share
  - Interim financial reporting
  - Segment reporting
- And
  - Special accounting for assets held for sale

Options excluded

- Financial assets: no available-for-sale or held-to-maturity financial assets
- Property, plant and equipment and intangible assets: revaluation not allowed
- Jointly-controlled entities: proportionate consolidation not allowed
- Investment property: choice between fair value model and cost model driven by circumstances
- Government grants: various options removed

Recognition and measurement simplifications …

Financial instruments:

- those meeting certain criteria are measured at amortised cost, all others at fair value through profit or loss
- simple principle for de-recognition
- simplified hedge accounting requirements

Goodwill and other indefinite-life intangible assets:

- Amortised over useful lives, with default of 10 years

Recognition and measurement simplifications …

Investments in associates and joint ventures:

- Can be measured at cost if not quoted. Equity method still permitted

Borrowing costs:

- Always expensed (no capitalisation)

Research and development costs:

- Always expensed

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Recognition and measurement simplifications …

Defined benefit plans:

- All actuarial gains and losses must be recognised immediately - either in profit or loss or in other comprehensive income: no more “corridor” and amortisation
- All past service cost must be recognised immediately
- Projected unit credit method still required, but only if it is possible without undue cost or effort: alternatively calculate based on years of service and salary at the balance sheet date

Recognition and measurement simplifications …

Income tax:

- Anticipated the IFRS Exposure Draft (now trashed)
- Tax basis determined assuming assets will be sold
- Measure assuming review by the tax authorities
- No initial recognition exception, other than for goodwill
- Recognise deferred tax assets, then reduce by a valuation allowance

Recognition and measurement simplifications …

Non-current assets held for sale

- No separate classification required: instead, intention to sell is an impairment indicator

Biological assets

- Still at fair value through profit or loss, but only when readily determinable without undue cost or effort: otherwise use cost/depreciation/impairment model

Simplifications not adopted

- Not to require a cash flow statement
- Treatment of all leases as operating leases
- Treat all employee benefit plans as defined contribution plans
- Completed contract method for construction contracts
- Cost model for agriculture as the benchmark treatment
- Fewer provisions
- No consolidation

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Significantly reduced disclosure requirements …

- Notably – 70 pages of IFRS 7 replaced by *"information that enables users of financial statements to evaluate the significance of financial instruments for its financial position and performance … (e.g. interest rate, repayment schedule, restrictions, etc)"*
- No fair value disclosures
- No disclosure of financial information of associates
- No comparative for movement in property, plant and equipment
- No need to provide a numerical 'tax reconciliation'

Transactions or events not dealt with

In the absence of a requirement in the IFRS for SMEs that applies to a specific transaction or event:

- Management shall use its judgement in developing and applying an accounting policy that is relevant (to the economic decision-making needs of users) and reliable (reflects the economic substance, neutral and prudent)
- Recognition criteria and measurement concepts in this IFRS
- Requirements in this IFRS for similar and related issues
- Requirements and guidance in the full IFRSs may be used, but is not mandatory

Transition to the IFRS for SMEs

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Date of transition …

… is the beginning of the earliest period for which comparative information is presented

E.g. If IFRS for SMEs was to be adopted for the first time for the year ending 31 December 2011, and comparative figures for 2010 were presented, the date of transition would be 1 January 2010

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Transition procedures …

General rule – restate the balance sheet at the date of transition to comply with IFRS for SMEs

Mandatory exceptions:

- Do not derecognise financial instruments that were previously recognised, and vice versa
- Do not change accounting estimates (e.g. impairment)
- Do not change hedge accounting
- Do not restate non-controlling interests

Transition procedures …

Voluntary exceptions (at date of transition):

- Fair value/revalued amounts can become deemed cost for property, plant and equipment, investment property, and intangible assets
- In separate financial statements, fair value of investments in subsidiaries, associates, and jointly controlled entities can become deemed cost
- Deferred tax does not need to be recomputed if it would involve undue cost or effort
- Etc

Disclosure/reconciliation

- A description of the nature of each change in accounting policy
- Reconciliations of its equity as previously reported and as restated, at the date of transition and the previous reporting date
- A reconciliation of the restated profit or loss for the comparative period to the previously reported profit or loss

SMEIG Q & As

SME Implementation Group (SMEIG)

Already formed – 21 members plus Chair

- Will draft 'Questions and Answers' for IASB approval
- Can propose amendments to IASB

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Final Q&A issued

- Use of *IFRS for SMEs* in a parent's separate financial statements
    - A parent entity that does not have public accountability may present its separate financial statements in accordance with the IFRS for SMEs even if it presents its consolidated financial statements in accordance with full IFRSs

Draft Q&As issued for public comment

- Captive insurance subsidiaries
  - An insurance company set up to insure risks of entities within a group of entities that are related is not publicly accountable (no broad group of outsiders)
- Interpretation of ‘traded in a public market’
  - Market must be accessible to a broad group of outsiders
  - Shares advertised for sale by a shareholder does not create an over-the-counter market
  - Availability of a published price does not necessarily mean securities are traded in a public market

Draft Q&As issued for public comment (cont)

- Investment funds with only a few participants
  - A few participants, particularly if involved in the fund's investment and management decisions, do not constitute a broad group of outsiders
- Application to financial periods ending before the *IFRS for SMEs* was issued *(allowed)*
- Interpretation of 'undue cost or effort' and 'impracticable'

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Draft Q&As issued for public comment (cont)

- Departure from one or more principles in the *IFRS for SMEs (not allowed)*
- Local regulation prescribes the format for the financial statements *(OK if no conflict)*
- Jurisdiction requires fallback to full IFRSs *(OK)*
- Fallback to IFRS 9 *(not allowed)*
- Recycling of cumulative exchange differences on disposal of a subsidiary *(not allowed)*

Conclusion

The IFRS for SMEs can be applied immediately by non-publicly accountable entities

Results in significantly simpler financial statements that will be easier to understand

The choice is yours, but beware:

- No revaluation of PPE
- No capitalisation of borrowing costs

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Thank you

Any questions?