The Financial Reporting Workshop- A Focus On SMEs

17th November – 18th November

Eldoret Branch

Topic: Overview of IFRS for SMEs

Learning Objectives

We should be able to achieve these goals:

- Define SMEs- (As per IFRS & Companies Act)
- Appreciate key advantages of IFRS for SMEs
- Understand the scope and concepts of IFRS for SMEs
- Highlight the key differences with full IFRSs
- Appreciate the key amendments following the comprehensive review of IFRS for SMEs

Contents:

1. Background

IFRS for SMEs was originally **published by the IASB in 2009**. The main aim was to **meet the needs of Private companies**. It is intended to ensure that lenders, investors and other stakeholders receive high quality financial Information to help them make lending and other decisions. **A cost-benefit approach** was taken in developing the IFRS for SMEs, with the emphasis on easing the financial reporting burden on private companies.

Full IFRS is aimed primarily at public-traded entities, and is used in over 110 Jurisdictions. However, there are far more privately owned companies than publicly-traded ones. The IFRS for SMEs was therefore developed for privately owned companies that need to choose to prepare financial statements. The IFRS for SMEs is currently used in over 70 Countries **(Including Kenya).**

2. Definition of SMEs

- The 'International Financial Reporting Standard for Small and Medium-sized Entities' (IFRS for SMEs) applies to all entities that do not have public accountability.
- **An entity has public accountability if:**

i. *Files its financial statements* with a securities commission or other regulatory organisation for the purpose of issuing any class of instrument in a public market,

ii. If it *holds assets in a fiduciary capacity* for a broad group of outsiders – for example, a bank, insurance entity, pension fund, securities broker/dealer.

3. Why IFRS for SMEs:

- The definition of an SME is therefore based on the **nature** of an entity **rather than on its size.**

Why IFRS for SMEs

(i) Difficulty & cost of preparing full IFRS,

(ii) Difference in focus between users of private company financial statements & users of public entities,

(iii) Meeting users' needs while balancing cost & benefits for preparers,

(iv) Modest disclosures more appealing to users &preparers.

4. Scope and Concepts

The term **'Small and Medium-sized Entities'** is slightly misleading. The applicability of the IFRS for SMEs is not in fact based on any explicit 'size' criteria.

This Standard is intended to apply to entities that in many countries are referred to by a variety of terms, including SMEs, private entities, and non-publicly accountable entities.

Small and Medium-sized Entities are therefore defined as entities that publish general purpose financial statements for external users and do not have public accountability

4. Scope and Concepts (Cont..)

- It is up to individual jurisdictions to decide which entities will be required or permitted to use the IFRS for SMEs. (The Kenya Companies Act, 2015 defines the small companies regime)

- If jurisdictions do allow publicly accountable entities to use IFRS for SMEs, these entities should state compliance with local GAAP, not with the IFRS for SMEs. (IFRS disclaimer).

4. Scope and Concepts (Cont..)

Scope for groups:

- Where consolidated financial statements of a parent company are on full IFRS, can the IFRS for SMEs then be used for the separate or individual financial statements of the companies in the group?

4. Scope and Concepts (Cont..)

- **Scope for groups- Cont..:**

Subsidiary

- A subsidiary whose parent (or group) uses full IFRS is not prohibited from using the IFRS for SMEs provided the subsidiary itself is **not publicly accountable.**

Parent

- As long as the parent entity itself **does not have public accountability,** it may produce its separate financial statements in accordance with the IFRS for SMEs even if its consolidated financial statements are in accordance with full IFRS.

4. Scope and Concepts (Cont..)

A complete set of financial statements prepared under the IFRS for SMEs includes:

- a statement of financial position as at the reporting date
- either (i) a single statement of comprehensive income or (ii) a separate income statement and a separate statement of comprehensive income
- a statement of changes in equity for the reporting period
- a statement of cash flows for the reporting period (this can be presented using either the direct method or indirect method)
- notes, comprising a summary of significant accounting policies and other explanatory information.

5. Kenya Companies Act, 2015

- The Act describes the criteria used to qualify a company as small.

- 623. The small companies regime for financial statements applies to a company for a financial year in relation to which the company:
  (a) qualifies as small; and
  (b) is not excluded from the regime.

5. Kenya Companies Act, 2015 (Cont..)

- **624. (1) A company qualifies as small in relation to** its first financial year if the qualifying conditions are satisfied in that year.
  (2) A company qualifies as small in relation to a subsequent financial year if the qualifying conditions —
  (a) are satisfied in that year and the preceding financial year;
  (b) are satisfied in that year and the company qualified as small in relation to the preceding financial year; and
  (c) were satisfied in the preceding financial year and the company qualified as small in relation to that year.

5. Kenya Companies Act, 2015 (Cont..)

- **624** (3) The **qualifying conditions** are satisfied by a company in a year in which it satisfies **two or more** of the following requirements —
  (a) it has a turnover of not more than fifty million shillings;
  (b) the value of its net assets as shown in its balance sheet as at the end of the year is not more than twenty million shillings; and

  (c) it does not have more than fifty employees.

  (4) For a period that is only part of a company's financial year, the maximum figures for turnover are to be adjusted proportionately.

5. Kenya Companies Act, 2015 (Cont..)

- 624 (5) In this section, "**the number of employees**" means the average number of persons employed by the company in the year, determined as follows
  (a) ascertain for each month in the financial year the number of persons employed under contracts of service by the company in that month (whether throughout the month or not);
  (b) add together the monthly totals; and
  (c) divide the result obtained under paragraph (b) by the number of months in the financial year.

5. Kenya Companies Act, 2015 (Cont..)

- 625. (1) A parent company qualifies as a small company in relation to a financial year only if the group of companies headed by it qualifies as a small group.

5. Kenya Companies Act, 2015 (Cont..)

- 625 (4) The qualifying conditions are satisfied by a group in a year in which it satisfies **two or more** of the following requirements —
  (a) the group has an **aggregate turnover of not more than fifty million shillings**;
  (b) the aggregate values of the **net assets** of the companies comprising the group as sh-own in the group's balance sheet as at the end of that year are **not more than twenty million shillings**; and
  (c) the group has **not more than fifty employees** in total.
  (5) The aggregate figures in subsection (4)(a) are calculated by adding together the relevant figures determined in accordance with section 624 for each member of the group.

5. Kenya Companies Act, 2015 (Cont..)

- **626.** (1) The **small companies regime does not apply** to a company that is or was at any time within the financial year to which the financial statements relates:

  (a) a public company

  (b) a member of an ineligible group.

  (2) A group is ineligible if any of its members is:

  (a) A Public company;

  (b) A body corporate (other than a public company) whose shares are admitted to trading on a securities exchange or other regulated market in Kenya, or

  (c) a person who carries on insurance market or banking activity.

5. Kenya Companies Act, 2015 (Cont..)

Accounting records - Key Issue to note for SMEs:

- **Section 628** obliges every company to keep proper accounting records.
- **Section 635** obliges the directors of every company to prepare a financial statement for the company for each financial year.
- The implications of these sections is that **no company is exempted** from preparing financial statements in every financial year even those falling under the small companies regime which includes SMEs

5. Kenya Companies Act, 2015 (Cont..)

Exemption of SMEs from mandatory Auditing:

- **Part XXVII** of the Act provides for auditing of company financial statements. **Section 709** obliges directors of companies to ensure that the company's annual financial statements for a financial year are audited unless the company is exempted under **Sections 711, 714 & 716.**

- **Section 711(2)** then outlines the conditions for exemption from those requirements; **if a company qualifies as a small company in that year**, its' turnover for the year is less than 50 million shillings and it's value of its net assets specified in its balance sheet is no more than 20 million shillings. **In this instance all the three conditions must be present**

6. Key Differences with full IFRS

FULL IFRS	IFRS FOR SMEs
(i) Numbered by standard	(i) Organised by topic
(ii) Over 3,500 disclosures	(ii) About 10% of full IFRS potential disclosures
(iii) Around 4,300 pages in length	(iii) Estimated to about less than 250 pages after revision
(iv) Updated several times a year	(iv) To be updated on a 3 year basis
(v) Several topics here have been dropped	(v) **Topics dropped include:** • segment reporting • interim reporting • earnings per share • assets held for sale

6. Key Differences with full IFRS (Cont..)

The IFRS for SMEs is **simplified** by including only the simpler option in some of the areas where full IFRS has a choice of alternative accounting treatments:

Examples:

(i) Investment property:

- Measurement at cost or fair value is driven by circumstances rather than by choice.

- Must be accounted for at fair value if such a value is available without undue cost or effort, otherwise the cost model should be used.

6. Key Differences with full IFRS (Cont..)

(ii) Intangible assets

No revaluation option

(iv) Government grants

No option between the income approach and capital approach that is available in full IFRS (depending on the circumstances).

6. Key Differences with full IFRS (Cont..)

(v) Undue cost or effort Exemption:

An undue cost or effort exemption means an entity **does not need to apply** the requirement noted in the Standard because of the excessive cost or the effort needed to apply it. If the **cost or effort significantly outweighs the benefit** the users would receive by having the information, then the entity can apply an exemption to the Standard's requirement.

Example:
A new undue cost or effort exemption now exists for the measurement of investments in equity instruments at fair value and the separate recognition of intangible assets of the acquiree in a business combination.

6. Key Differences with full IFRS (Cont..)

Recognition and measurement simplifications:

Subject	Full IFRS	IFRS for SMEs
(i) Goodwill	Annual impairment tests, no amortisation	Goodwill amortised, max 10 years or as per management's judgment.
(ii) Research & Development	Development costs capitalised when required criteria is met.	All research & development costs are expensed
(iii) Financial Instruments	•4 categories of FI •Over 100 pages of implementation guidance	•2 categories (amortised cost & FV through P&L) •Much simplified implementation guidance.
(iv) Borrowing costs	•Borrowing costs capitalised for qualifying asset •Distinction between specific & general borrowing costs.	Capitalisation not permited, all borrowing costs are expensed

7. Amendments

The IASB commenced its initial comprehensive review of the IFRS for SMEs in 2012, three years after its release in 2009. The aim of the review was to consider whether the IFRS for SMEs needed amending for any implementation issues identified or for any changes made to full IFRS.

The IASB issued the resulting Amendments in May 2015.

While a total of 56 Amendments have been made, the majority of these only clarify existing guidance or provide additional supporting material rather than change the underlying requirements of the Standard.

7. Amendments (cont..)

(i) Measurement of property, plant and equipment

Entities reporting under the IFRS for SMEs to choose between measuring their property, plant and equipment at cost, or at fair value using the 'revaluation model'. Previously, the Standard had permitted only the 'cost model' (in Section 17).

7. Amendments (cont..)

(ii) Recognition and measurement of deferred income tax assets and liabilities

The Amendments align the accounting requirements of deferred tax with IAS 12. This means that entities applying the IFRS for SMEs and those reporting under full IFRS will now follow the same basic principles when determining when to recognise deferred tax assets and liabilities and the amount at which they must be measured.

7. Amendments (cont..)

(iii) Exploration for and evaluation of mineral Resources.

These Amendments provide entities reporting under the IFRS for SMEs with additional flexibility that was previously available only to those reporting under full IFRS.

The Amendments align the main recognition and measurement requirements in Section 34 for exploration and evaluation assets (E&E) with IFRS 6 ‘Exploration for and Evaluation of Mineral Resources’. Entities will now be allowed to make a policy choice as to which expenditures will be included in E&E assets, and will use more favourable guidance when identifying whether an E&E asset might be impaired.

7. Amendments (cont..)

(iv) 'Undue cost or effort' exemptions

- IASB has provided additional 'undue cost or effort' exemptions, where available, these provide relief from applying a particular 'benchmark' accounting approach if that form of accounting would require undue cost or effort for the company.

- The exemptions can be applied if the incremental cost (for example valuer's fees), or additional effort (for example by employees) is expected to substantially exceed the benefit provided to the users of the financial statements from having this information.

8. Transition and effective date

- The new version of the Standard must be applied to annual periods beginning on or after 1 January 2017.

- Early adoption is allowed provided that all of the changes are applied at the same time. The Amendments must be applied retrospectively, with the following exceptions:

- If an entity chooses to apply the revaluation model to any classes of property, plant and equipment, it must apply the related requirements prospectively from the beginning of the period

- An entity is permitted to apply the revised income tax requirements prospectively from the beginning of the period.

- For business combinations, an entity must apply the clarified terminology relating to ‘date of acquisition’ prospectively from the beginning of the period.

9. Interactive Session


THANK
YOU!

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