

IFRS For Smes-based Not-for-profit Guide To Financial Reporting

Uphold public interest

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February 20 2020

SMEs are entities that:



- do not have public accountability, and
- publish general purpose financial statements for external users.

The IFRS for SMEs is designed to meet the needs and capabilities of (SMEs).

SMEs account for over 95% of all entities around the world.

- ❖ The standard does not contain a limit on the size of an entity that may use the IFRS for SMEs provided that it does not have public accountability
- ❖ There is no restriction on its use by a public utility, not-for-profit entity, or public sector entity
- ❖ A subsidiary whose parent or group uses full IFRSs may use the IFRS for SMEs if the subsidiary itself does not have public accountability.
- ❖ **Listed companies, no matter how small, may not use the IFRS for SMEs**

IFRS for SMEs is less complex in a number of ways:



- Topics not relevant for SMEs are omitted eg EPS, Segment reporting
- Many principles for recognizing and measuring assets, liabilities, income and expenses in full IFRS are simplified.

- Fewer disclosures are required (roughly a 90% reduction).
- The Standard has been written in clear, easily translatable language.
- Revisions are expected to be limited to once every three years. 2009, 2015...

The preface to the IFRS for SMEs notes that the standard is developed for profitorientated entities. Section 1 prohibits entities that have public accountability from using the IFRS for SMEs. 'Public accountability' is defined in terms of debt and equity instruments traded in a public market or banks and similar institutions

- This definition does not include not-for-profit organisations and consequently the IFRS for SMEs may be adapted for use by not-for-profits.

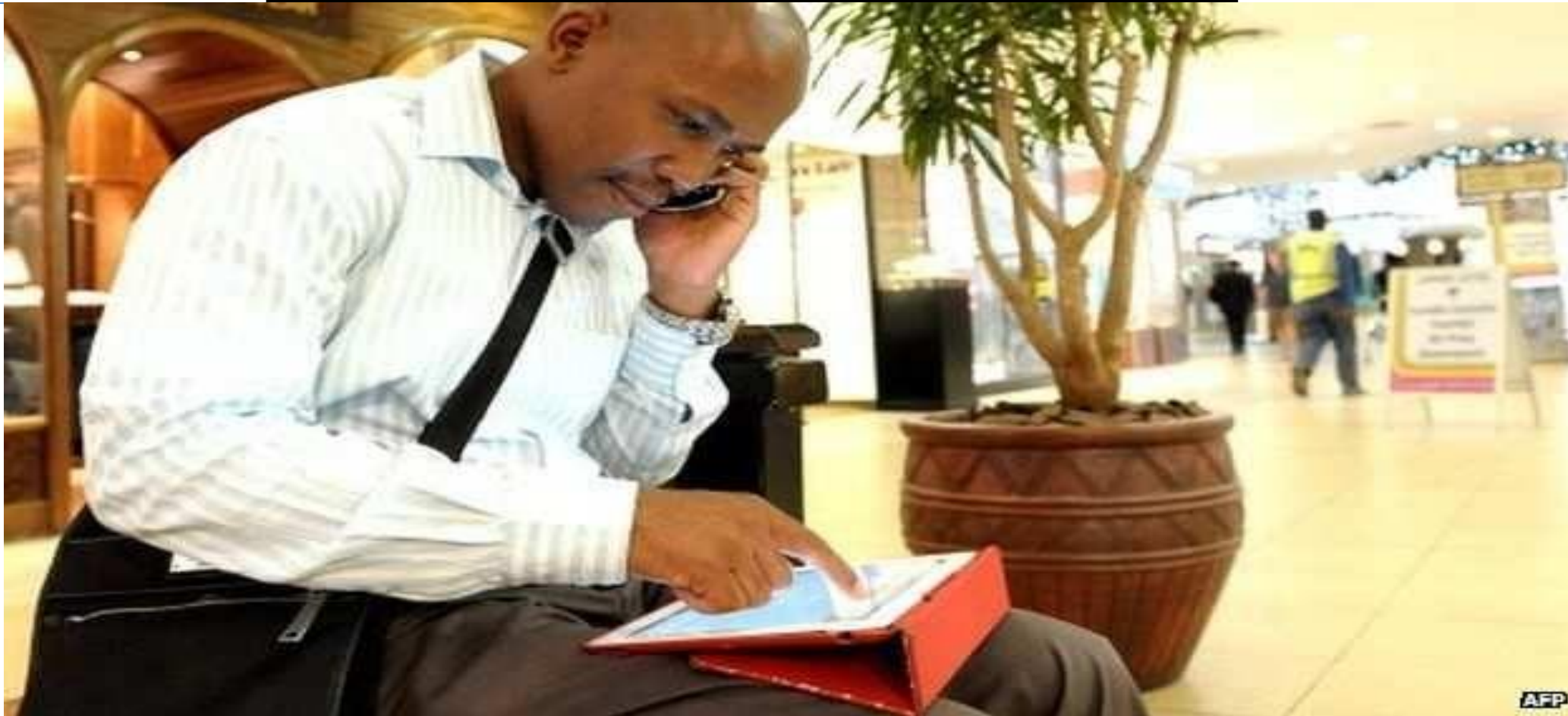
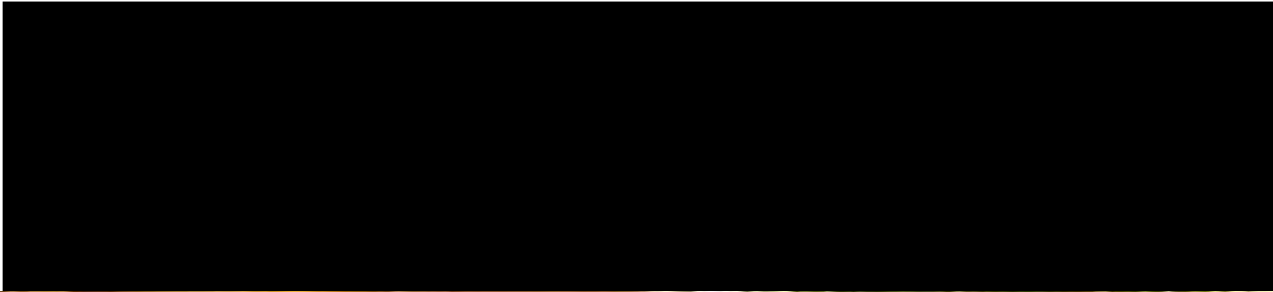
Not-for-profits are established for a social purpose but their public accountability is not to capital markets but to public stakeholders, normally funders, donors, financial supporters, service users and other beneficiaries, and, if applicable, to the organisation's members. Therefore a not-forprofit organisation should provide additional information to help stakeholders understand its activities and how funds have been used.

- The emphasis of not-for-profits is not on generating a distributable return from cash flows but on using its economic resources to achieve a social purpose.

The objective of not-for-profits in preparing their financial statements goes beyond financial position, performance and cash flows. Stakeholders will want to see that any restrictions on the use of funds have been complied with, identify how the funds were used for social purposes, and determine whether the organisation has the capability to continue its work.



In place of classes of equity, not-forprofits have retained funds that may be unrestricted, and available for any purpose of the organisation, or restricted in their use in some way



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 plus in full IFRSs
- **Organised by topic**
- **Simplifications** from full IFRSs

How is it simplified?

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

- **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?

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- **Improved access to capital**
 - This is the priority area for SMEs
- **Improved comparability**
- **Improved quality of reporting** as compared to existing national GAAP
- **Less of a burden** for entities in jurisdictions where full IFRSs or full national GAAP are now required.

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”.

What would the audit report say?

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Unreserved statement of compliance

- **What the unreserved statement of compliance should state;**

The financial statement have been prepared in accordance with the provision of International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs)

- **What would the audit report should state :**

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

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

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- **Objective:** Information about financial position, performance, cash flows
 - Also shows results of stewardship of management over resources
- **Qualitative characteristics:** Relevance, reliability, etc
- **Definitions:** Asset, liability, equity
- **Definitions:** 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

- **Fair presentation:** presumed to result if *IFRS for SMEs* is followed (maybe need for supplemental disclosures)
- **Full compliance:** State compliance with *IFRS for SMEs* only if the financial statements comply in full
- **Comparatives:** At least one year comparative financial statements and note data

- **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 Comprehensive Income:

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

Section 3 Financial statement presentation

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- 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:
 1. Some foreign exchange gains and losses
 2. Some changes in fair values of hedging instruments
 3. Some actuarial gains and losses

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 Income Statement and Statement of Comprehensive Income

- 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 proposed to drop the two-statement approach in full IFRSs.

Section 5 Income Statement and Statement of Comprehensive Income

- 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

- 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

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

- 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

- Consolidation is required when parent-sub 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

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- 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

- **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 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 (IFRS 9) instead of sections 11 and 12
 - Even if IAS 39 (IFRS 9) is followed, make Section 11/12 disclosures (not IFRS 7 disclosures)

- **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

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- 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.**

- **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

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- 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)

- 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)

Cost and FV models are not allowed by IAS 28.

- 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 IFRS 11.

Section 16 Investment property

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- 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

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

IAS 16 allows revaluation 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

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- 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

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- 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

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- 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

- **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

- 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

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- 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

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- 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 or death or retirement of owner, 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.

- 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: Recognised by percentage of completion
- Principle for measurement is fair value of consideration received or receivable

Section 24 Government grants

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- 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

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- 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

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- 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

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- **Inventories** - write down 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

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- 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

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- 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

Same as IAS 19 Revised which eliminated those options

- Recognise deferred taxes if the tax basis of an asset or liability is different from its carrying amount
- 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

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- 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 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

- 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

- 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

- 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

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- Agriculture – use historical cost model unless fair value is readily determinable without undue cost or effort

IAS 41 requires FVTPL for all biological assets and agricultural produce.

- Oil and gas and mining – not required to charge exploration costs to expense
- Service concession arrangements – financial assets = FV & Amort.Cost; intangible assets = FV & C-D-I

Section 35 First-time adoption

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- 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

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

(a) The character of funds



Fund accounting distinguishes between two primary classes of fund: those funds that are unrestricted in their use, which can be spent for any purposes of the organisation, and those that are restricted in use.

Separating out income and gifts and expenditure relating to the social purpose

Funders and financial supporters, an organisation's members and those benefiting from its work will be interested in how it has used the funds at its disposal to achieve its social purposes. The single performance statement includes all income, gains, expenditure and losses recognised for the reporting period.

End

GOD BLESS YOU ALL

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