Grant Thornton

IFRS News Special Edition

> "The potential of this new standard is that we move to a situation where lenders and investors are able to assess company performance from financial statements that use directly comparable, authoritative, internationally recognised principles, regardless of the country of origin of the company itself."
>
> **Alex MacBeath**
> Global Leader of Privately Held Business Services for Grant Thornton International

The IFRS for Small and Medium-sized Entities

The International Financial Reporting Standard for Small and Medium-Sized Entities ("IFRS for SMEs") is a simplified version of full IFRS aimed at the needs of private companies.

Published by the International Accounting Standards Board (IASB) on 9 July 2009, the IFRS for SMEs has the potential to revolutionise and harmonise financial reporting by private companies across the world.

Why has the IASB issued this Standard? In short, the answer is to respond to a demand. Full IFRS is developed primarily for publicly-traded entities. Right now over 100 countries require or permit the use of IFRS-based standards for such companies.

However, there are far more privately held companies than publicly-traded ones. Many private companies prepare financial statements but, in much of the world, these statements are based on local requirements.

Now, for the first time, there is an internationally recognised reporting framework for private companies intended to assist those involved in their financing, to assess performance and make decisions on a like-for-like basis. Furthermore a cost-benefit approach has been taken in developing the IFRS for SMEs, with the emphasis being on easing the financial reporting burden on private companies.

This special edition of IFRS News tells you more about the new Standard.

Who can use the IFRS for SMEs?

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

It is up to individual jurisdictions to decide which entities will be required or permitted to use the IFRS for SMEs

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

An entity is publicly accountable if it:

- files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or
- it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (eg banks, insurance companies, and mutual funds).

Entities which hold assets in a fiduciary capacity for reasons incidental to a primary business (eg travel agents, schools and utility companies) are not however considered to be publicly accountable and can use the IFRS for SMEs.

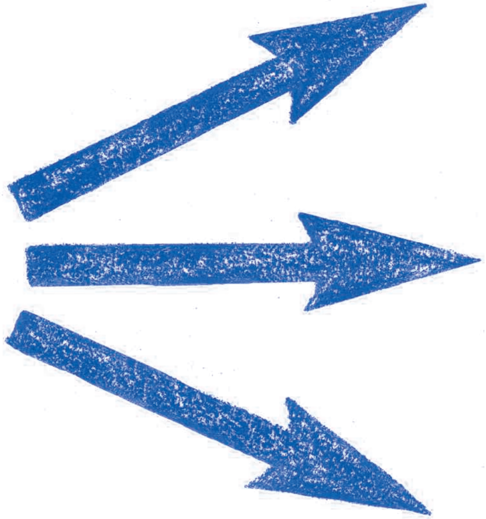
The IFRS for SMEs is effective immediately on issue. It is however up to individual jurisdictions to decide which entities will be required or permitted to use the IFRS for SMEs – the Standard does not itself deal with this question.

The IFRS for SMEs is separate from full IFRS and is therefore available for any jurisdiction to adopt whether or not it has adopted full IFRS.

Some 99% of private entities around the world are expected to fall within the scope of the IFRS for SMEs

"Increasingly, unlisted companies are trading globally or receiving funding from international sources. Having financial statements that follow an international standard is likely to improve their access to funding, currently a critical issue for many businesses."

Brian Shearer
National Director of Financial Reporting at Grant Thornton United Kingdom



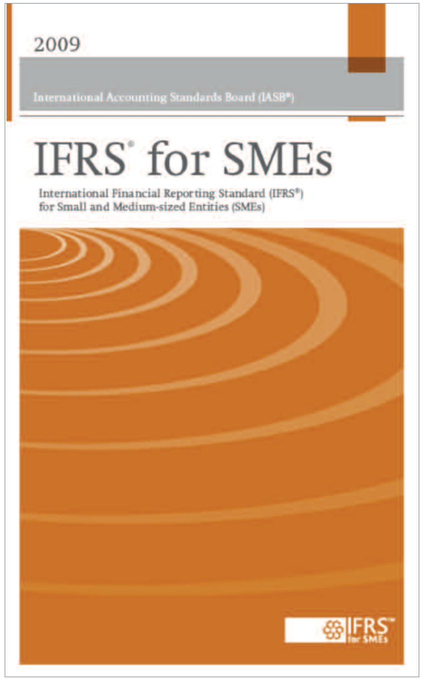
About the new Standard

What does the IFRS for SMEs look like?

The IFRS for SMEs is a self-contained standard of less than 230 pages built on the foundation of full IFRS.

Many of the principles for recognising and measuring assets, liabilities, income and expenses have however been simplified. Furthermore, topics not relevant to SMEs have been omitted, and the number of required disclosures has been significantly reduced.

Future revisions to the IFRS for SMEs will be limited to once every three years, providing a stable platform to both preparers and users of financial statements prepared under it.



IFRS for SMEs compared to full IFRS

Full IFRS	IFRS for SMEs
Numbered by Standard	Organised by topic (eg inventories)
Around 3,000 potential disclosures	Around 300 potential disclosures
Around 2,800 pages in length	Less than 230 pages
Updated several times a year	Anticipated to be updated on a 3-yearly basis

> "The IFRS for SMEs will provide a significant reduction in the costs of preparing financial statements compared with using full international standards"
>
> **Keith Reilly**
> National Head of Professional Standards at Grant Thornton Australia

What are the simplifications compared to full IFRS?

Compared to full IFRS, the IFRS for SMEs contains a number of simplifications. Principal amongst these are the use of simplified drafting in writing the Standard, making the final document easier to understand and follow, and a reduced number of disclosures to be made when preparing financial statements.

The IFRS for SMEs also omits a number of topics found in full IFRS that are not considered to be relevant to the needs of small and medium-sized entities.

Topics omitted from the IFRS for SMEs:

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

The IFRS for SMEs is further simplified by including only the simpler option (or a modified version of the simpler option) in many of the areas where full IFRS has a choice of alternative accounting treatments.

The following table illustrates some examples of options available under full IFRS that are not included in the IFRS for SMEs:

Options in full IFRS not included in the IFRS for SMEs	
Joint ventures	• No proportionate consolidation • Option to account for all joint ventures either at cost; under the equity method; or at fair value through profit or loss (compulsory where a quoted price is available)
Property, plant or equipment	• No revaluation option
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
Post-employment defined benefit plans	• The 'corridor' approach for recognising actuarial gains and losses is not permitted
Intangible assets	• No revaluation option

In addition, the IFRS for SMEs gives greater consideration to 'cost/benefit' criteria in relation to the application of fair value accounting. For example, directors' judgement can be used in estimating the value of share-based payments and the cost model is used for biological assets (living animals or plants) unless fair value is readily determinable without undue cost or effort.

A snapshot guide to the IFRS for SMEs, using the same section headings as the Standard, is set out at the end of the newsletter.

The IFRS for SMEs also contains important simplifications to the recognition and measurement principles in full IFRS. The following table sets out some of the main simplifications:

Recognition and measurement simplifications – examples

Subject	Full IFRS	IFRS for SMEs
Goodwill	• Goodwill not amortised but annual impairment testing required	• Goodwill amortised (presumed life of 10 years where a reliable estimate of useful life cannot be made) • Impairment testing only needed where indicator of impairment exists
Research and development	• Development costs capitalised where 6 specific criteria are met	• All research and development costs expensed
Financial instruments	• 4 categories of financial instruments • Hedge accounting only possible where strict documentation and effectiveness requirements are met • Over 100 pages of detailed implementation guidance	• 2 categories (amortised cost or fair value through profit or loss) • Much simplified (albeit restricted) rules on the use of hedge accounting
Borrowing costs	• Borrowing costs directly attributable to acquisition, construction or production of a qualifying asset are capitalised • Distinction drawn between general borrowing costs and specific borrowing costs • For general borrowings, a capitalisation rate, based on the weighted average of borrowing rates applicable to the general outstanding borrowings during the period, is applied to determine the amount to be capitalised	• All borrowing costs are expensed

Illustrative financial statements and disclosure checklist

Unlike full IFRS, the IFRS for SMEs contains illustrative financial statements and a disclosure checklist.

With around only 300 potential disclosure requirements, compared to 3,000 under full IFRS, the advantages of the IFRS for SMEs in terms of the amount of time to be spent preparing the financial statements are already clear.

The point is underlined however, by the Illustrative Financial Statements that the IASB has prepared to accompany the Standard. At just 17 pages in length, they compare favourably to full IFRS financial statements which often run to over 100 pages.

Why should jurisdictions consider adopting the IFRS for SMEs?

We believe the IFRS for SMEs will be particularly welcome in those countries that currently require full IFRS to be used for all entities, listed and unlisted, due to the reduced complexity of the Standard compared to full IFRS.

There are around 30 such countries which currently require the use of full IFRS for unlisted companies. These countries include:

- Armenia; Bahrain; Costa Rica; Cyprus; Dominican Republic; Ghana; Guatemala; Guyana; Haiti; Honduras; Jamaica; Kazakhstan; Kenya; Kuwait; Krygyzstan; Mongolia; Montenegro; Nepal; Nicaragua; Oman; Panama; Republic of Serbia; Sierra Leone; Slovak Republic; Tajikistan; Trinidad and Tobago; Ukraine; Venezuela

In addition, many countries permit full IFRS to be used by some of their unlisted companies. These countries may also benefit from the adoption of the simplified framework of the IFRS for SMEs. Countries which use IFRS equivalents for domestic unlisted companies, such as Australia and New Zealand, are also likely to benefit from its adoption.

> "The final standard has now been approved for use in South Africa. We are encouraging all our clients that meet the criteria to switch to the IFRS for SMEs."
>
> **Frank Timmins**
> Head of Risk Management and Professional Standards at Grant Thornton South Africa

The South African experience

South Africa is an example of a country that required all companies to use IFRS and is set to benefit from the introduction of the IFRS for SMEs.

In fact the potential benefits from the IFRS for SMEs were perceived as so great that South Africa adopted the Exposure Draft which preceded the IFRS for SMEs in October 2007 as a Statement of Generally Accepted Accounting Practice for SMEs in South Africa.

The move was seen as reducing the reporting burden on SMEs, providing them with a simpler accounting framework that was easier to understand and apply than full IFRS. It also provided relief from many of the disclosures required by full IFRS.

Indeed, the move proved so popular that South Africa has quickly published the final version of the IFRS for SMEs (without any change to the text) as a Statement of Generally Accepted Accounting Practice. Entities falling within the scope of the IFRS for SMEs may apply it for annual financial statements that are authorised for issue after 13 August 2009.

Commenting on its publication, Frank Timmins, Head of Risk Management and Professional Standards at Grant Thornton South Africa, and a member of the IASB Working Group for SMEs said:

"By September 2008 more than 70% of our private company clients had adopted the Exposure Draft. Most of those who had not were waiting for the final standard. We are pleased to see that the final version of the IFRS for SMEs includes improvements that respond to many of South Africa's concerns and we welcome its publication.

The final standard has now been approved for use in South Africa. We are encouraging all our clients that meet the criteria to switch to the IFRS for SMEs."

For those countries not currently using full IFRS for private entities, the IFRS for SMEs may also offer advantages in terms of being easier to apply than local GAAP, or enabling companies to attract funding from overseas sources.

It is not just private businesses that may benefit. Most listed companies have subsidiaries and many of those subsidiaries are required to produce individual financial statements. Those listed companies may apply full IFRS at group level but be faced with several different national requirements at subsidiary level. IFRS for SMEs offers an opportunity to harmonise reporting by subsidiaries based on a framework that is founded on full IFRS but is significantly simpler.

Potential benefits of adopting the IFRS for SMEs

- **Improved access to capital**
- **Improved quality and comparability of reporting**
- **Facilitates cross-border trading**
- **Focused on the needs of users of SME financial statements**
- **Audit efficiencies**
- **Stability – initial 2-year comprehensive review followed by 3-yearly omnibus updates**
- **Eases burden where full IFRS has previously been required**
- **Stepping stone to full IFRS for private entities aiming for an Initial Public Offering**

The challenges of adopting the IFRS for SMEs

As noted above, the IASB took a cost-benefit approach in developing the IFRS for SMEs. Nevertheless, converting to new accounting principles always involves some degree of financial and resource cost, which can sometimes be harder for smaller companies to handle.

These costs need to be carefully considered by companies thinking of adopting the IFRS for SMEs. Challenges that private businesses may face include:

Learning new terminology and accounting techniques

- businesses and their advisers will have to learn new terminology and accounting techniques and make changes to their information systems and accounting software
- management reporting processes may need to be reviewed
- businesses may need to collect additional data about some of their transactions

New concepts

- for companies that have used local GAAP that is not based on IFRS, some of the terminology and concepts in the IFRS for SMEs may be unfamiliar. For example, the need to apply fair value accounting for some transactions, to prepare a Statement of Cash Flows or to consolidate subsidiaries

Valuation issues

- while the IFRS for SMEs has attempted to limit the use of fair value to situations where the benefits from its use outweigh the costs, the use of fair values may still be more widespread than under local GAAP
- for example, the requirement to recognise an expense for share-based payments based on the fair value of the instruments provided will be a new concept in many countries. The use of a valuation expert may be necessary in some situations in order to arrive at the fair value

> "The cost versus benefit of financial reporting for private entities is not just a consideration in countries using IFRS, or for that matter US GAAP. This new standard has the potential to start a worldwide revolution in private company reporting. This could be huge."
>
> **Gary Illiano**
> National Partner-in-Charge, International and Domestic Accounting at Grant Thornton United States

United States removes barriers to using the IFRS for SMEs

US private companies are not required to use a particular basis of accounting when preparing their financial statements. The choice of which financial accounting and reporting framework to follow depends upon each company's objectives and the needs of their users.

In May 2008, the American Institute of Certified Public Accountants (AICPA) voted to recognise the IASB as an accounting body for the purpose of establishing international financial accounting and reporting principles.

In doing so, the AICPA removed a key professional barrier to using IFRS and therefore the IFRS for SMEs. Practically speaking, this means that many private companies can prepare their financial statements in accordance with IFRS for SMEs (individual companies should check their eligibility with the appropriate state board of accountancy).

Some US private companies, particularly those with foreign interests, are likely to find the simplified IFRS for SMEs an attractive alternative to the more complicated and voluminous US GAAP. Change always involves some financial and time cost, however, and this will need to be weighed up against the benefits of adoption.

When and how will the IFRS for SMEs affect my business?

It depends where you are based, which in turn usually determines the accounting rules that currently apply to you. Over the coming months, regulators in individual countries will consider the new standard, consult locally and decide whether and when the IFRS for SMEs should be used in their jurisdiction.

If the IFRS for SMEs is adopted in your country, there will be new terminology to learn and changes to make to your information systems. In addition, changing from local GAAP to the IFRS for SMEs may have an effect on the actual operations of the company. Potential areas of impact include:

Distributable profits

- where the calculation of profits available for distribution in a country is interlinked with the calculation of accounting profits, consideration will need to be given to the impact of any changes resulting from adopting the IFRS for SMEs
- for example, the recognition of deficits on defined benefit pension plans or the effect of items that are accounted for at fair value through profit or loss

Tax

- in some countries, a move away from local GAAP will have implications for tax. Where this is the case, consideration will need to be given to the effect on cash payments and future tax planning

Impact on loan covenants

- Consideration will need to be given to the effect of adopting the IFRS for SMEs (changes in gearing, etc) on loan covenants and other agreements with borrowers

Where the IFRS for SMEs is to be adopted, more detailed consideration will need to be given to the transition to the new Standard. For example, advance planning may be required to gather the information needed for the comparatives in the financial statements and the opening balance sheet at the start of that earliest comparative period.

What happens next?

What can I do now?

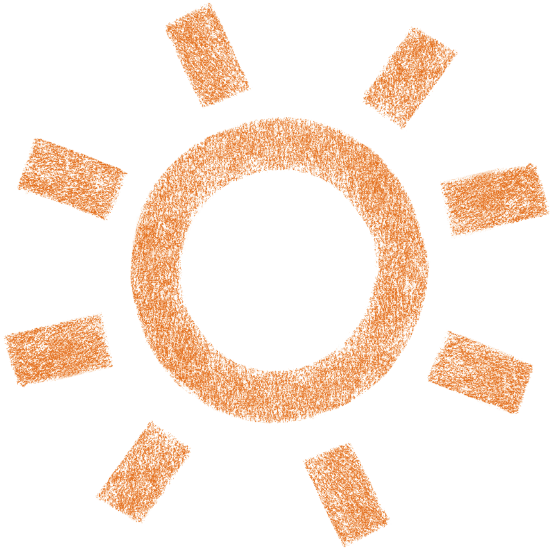
Make sure your voice is heard in any local consultation on whether the IFRS for SMEs should be adopted. Your local Grant Thornton contact will be monitoring developments in your country and will be able to tell you how.

If you believe you will benefit from the adoption of the IFRS for SMEs, or just want to know more, please get in contact with us.

GTI comment

We believe the IFRS for SMEs could transform the way privately held businesses prepare their financial statements, offering a unique opportunity to create a standardised accounting framework for such businesses throughout the world.

Of course there are always costs to be incurred when changing from one financial reporting framework to another. The benefits of the IFRS for SMEs are clear however and for many companies will outweigh any short term conversion disruption. We therefore urge private companies around the world to get engaged in the consultation on its use in their jurisdiction.



Snapshot of the IFRS for SMEs

Set out below is a highly summarised snapshot guide to the IFRS for SMEs, using the same section headings as the Standard. This Snapshot is intended to provide an 'at a glance' overview of the main requirements. It is not a substitute for studying the Standard itself and does not provide sufficient detail to apply the Standard's requirements.

Snapshot of the IFRS for SMEs

Number	Title	Description
1	Small and Medium-sized Entities (SMEs)	Defined as entities that (a) do not have public accountability, and (b) publish general purpose financial statements for external users.
2	Concepts and Pervasive Principles	Major concepts and basic principles underlying the financial statements of SMEs, such as definitions of assets, liabilities, income and expenses.
3	Financial Statement Presentation	A complete set of financial statements comprises: (a) a statement of financial position; (b) either a single statement of comprehensive income, or a separate income statement and a separate statement of comprehensive income; (c) a statement of changes in equity; (d) a statement of cash flows; and (e) notes, comprising a summary of significant accounting policies, other explanatory information, and comparatives.
4	Statement of Financial Position	A Statement of Financial Position consists of certain minimum line items. These items are classified as either current or non-current unless a presentation based on the liquidity of the items provides information that is more reliable and relevant.
5	Statement of Comprehensive Income and Income Statement	Total comprehensive income is presented in either a single statement of comprehensive income or in two statements (an income statement and a statement of comprehensive income).
6	Statement of Changes in Equity and Statement of Income and Retained Earnings	Changes in an entity's equity for a period are presented either in a statement of changes in equity or, if certain conditions are met and an entity chooses, in a statement of income and retained earnings. A statement of income and retained earnings can be used where the only changes to the entity's equity during the period arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy.
7	Statement of Cash Flows	Changes in cash and cash equivalents are reported, showing separately changes from operating activities, investing activities and financing activities.

Snapshot of the IFRS for SMEs

Number	Title	Description
8	Notes to the Financial Statements	Significant accounting policies are disclosed, together with details of judgements made and key sources of estimation uncertainty.
9	Consolidated and Separate Financial Statements	A parent entity is required to present consolidated financial statements in which all its subsidiaries are included. There are some limited exceptions to this rule.
10	Accounting Policies, Estimates and Errors	Prior period errors are accounted for on a retrospective basis. Changes in accounting estimate are recognised prospectively. Changes in accounting policy are accounted for on a retrospective basis unless specific transitional provisions apply.
11*	Basic Financial Instruments	An amortised cost or cost less impairment model is used for basic financial instruments such as cash, loans and trade receivables and payables.
12*	Other Financial Instruments Issues	Other financial instruments are generally measured at fair value through profit or loss. Examples of such instruments include asset backed securities, options, futures contracts, forward contracts, and interest rate swaps. Hedge accounting is permitted only for certain specific types of risk. Certain conditions must be met in order to use hedge accounting.
* Entities can choose to either apply the provisions of both Section 11 and Section 12 of the IFRS for SMEs in full or the recognition and measurement provisions of IAS 39		
13	Inventories	Inventories are measured at the lower of cost and net realisable value.
14	Investments in Associates	Investments in associates are measured using either: • the cost model (cost less accumulated impairment); • the equity model (initial recognition at cost, with subsequent adjustments to reflect the investor's share of the profit or loss and other comprehensive income of the associate); or • the fair value model (compulsory where a published price exists for the investment).
15	Investments in Joint Ventures	A similar accounting policy election to that for associates applies to investments in joint ventures. Proportionate consolidation is not permitted.
16	Investment Property	Investment property whose fair value can be measured reliably without undue cost or effort is accounted for at fair value through profit or loss. Otherwise investment property is accounted for at cost less depreciation and impairment.

Snapshot of the IFRS for SMEs

Number	Title	Description
17	Property, Plant and Equipment	Property, plant and equipment is measured at cost less depreciation and impairment.
18	Intangible Assets other than Goodwill	All internally developed intangibles, including all research and development activities, are expensed as incurred. Acquired intangibles meeting the criteria for recognition are capitalised as assets and measured at cost less amortisation and impairment. All intangible assets are considered to have a finite useful life. Revaluation of intangible assets is not permitted.
19	Business Combinations and Goodwill	Goodwill is measured at cost less amortisation and impairment. Where an entity is unable to make a reliable estimate of the useful life of goodwill, its life is presumed to be ten years and amortised over that period.
20	Leases	Finance leases are recognised as an asset by the lessee. Lease payments under operating leases are recognised by the lessee as an expense. Classification of leases depends on the substance of the transaction rather than the form of the contract.
21	Provisions and Contingencies	Present obligations are recognised as provisions when there is a probable outflow of economic benefits and the amount of the obligation can be estimated reliably. Contingent liabilities and contingent assets are not recognised but are disclosed in the notes.
22	Liabilities and Equity	Equity is the residual interest in the assets of an entity after deducting all its liabilities. A financial liability is a present obligation of the entity arising from past events, which is expected to result in an outflow of economic benefits. Split accounting must be applied to compound financial instruments, such as convertible debt, which contain both a liability and an equity component.
23	Revenue	For the sale of goods, revenue is recognised on transfer of the significant risks and rewards of ownership. In most cases, this will coincide with the transfer of legal title or the passing of possession to the buyer. For services and construction contracts, revenue is recognised according to the stage of completion at the end of the reporting period. Interest and royalties receivable are recognised on an accrual basis. Dividends are recognised when the right to receive payment is established.
24	Government Grants	Government grants are recognised in income when any specified performance conditions have been met. Where there are no such conditions, the grant is recognised in income upon receipt.

Snapshot of the IFRS for SMEs

Number	Title	Description
25	Borrowing Costs	All borrowing costs are expensed as incurred.
26	Share-based Payment	Employee share awards and share options are recognised as an expense in profit or loss over the vesting period. A corresponding credit is recognised in equity. These amounts are measured at the fair value of the instruments provided.
27	Impairment of Assets	An impairment loss is recognised when the carrying amount of an asset exceeds its recoverable amount.
28	Employee Benefits	Contributions payable under defined contribution plans are recognised as expenses in the period in which they are due. For defined benefit pension plans, an entity recognises a liability for its obligations net of the plan's assets. The net change in the liability during the period is recognised as the cost of the plan during the period. Entities can choose to recognise all actuarial gains and losses in either profit or loss or in other comprehensive income.
29	Income Tax	Deferred tax is calculated using a temporary difference approach based on the difference between the carrying amount of an asset and its tax base.
30	Foreign Currency Translation	Foreign currency transactions are translated into the functional currency of the reporting entity. All monetary items and those non-monetary items which are measured at fair value are subsequently retranslated at the end of each reporting period.
31	Hyperinflation	Entities subject to hyperinflation are required to state all amounts at the prices that are current at the end of the reporting period.
32	Events after the End of the Reporting Period	Adjustment is made for events that provide evidence of conditions that existed at the end of the reporting period. No adjustment is made for events that are indicative of conditions that arose after the end of the reporting period, although they are disclosed.
33	Related Party Disclosures	Disclosures draw attention to the existence of related parties and transactions and balances with such parties.
34	Specialised Activities	Guidance is provided for three types of specialised activities – agriculture, extractive activities, and service concessions.
35	Transition to the IFRS for SMEs	Mandatory exceptions to and optional exemptions from the full requirements of the IFRS for SMEs enable the Standard to be applied more easily by entities adopting it for the first time.