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A comparison between full IFRS and IFRS-SME

Företagsekonomi D

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Content

Introduction

The purpose with this paper is to compare full IFRS with the IFRS for SMEs. The intention is to see what differences and how to reach a harmonization of the accounting standards. To understand this paper better, I have chosen to write about various accounting standards mostly because the IFRS for SMEs is based on achieving a harmonization of accounting standards.

Method

This paper is based on different scientific articles, lectures at Karlstads University, fundamental literature and Internet sources. This paper is divided in three sections a theoretical, analysis and conclusions part.

Theory

IAS/IFRS- standards

The international organization, International Accounting Standard Board (IASB) continuously gives out accounting standards known as IFRS-standards. These standards are since 2005 compulsory for listed companies within EU.

As mentioned the international standards IAS/IFRS (International Accounting Standards and International Financial Reporting Standards) became compulsory for listed companies in Sweden the 1st of January 2005, and by that compulsory in the consolidated accounting only. Parent companies in Sweden that establish their consolidated accounting with IAS/IFRS should have this as a general rule according to The Swedish Financial Accounting Standards Council. (Sundgren 2007) IAS published 1970 which was formed to IASC (International Accounting Standards Committee) 1973, these standards had a major influence on FARs recommendations from the very beginning. Through initiatives from FAR the Swedish Financial Accounting Standards Council was formed, 1989. The Swedish Financial Accounting Standards Councils recommendation became important as they were based on IAS. (Alexander 2009 ; Sundgren 2007)

This gave the result that listed companies in Sweden were out early with applying accounting rules that was similar to IAS, as long as they didn't come in conflict with the Swedish tax legislation. IASC was in 2001 recreated to IASB which issue accounting standards IFRS. The interpretations of these standards are given by IFRIC (International Financial Reporting Interpretations Committee) that is considered being an official interpretation regulation. From the beginning EU didn't support IASC but over the time EU became the main supporters. IFRS became compulsory for listed companies, in 2005. The main reason with international standards is to make the accounting between countries comparable, and by that achieve a fair presentation.[1] One example is that companies will get same access to the world capital market, which is very important. (Sundgren et al. 2007)

Although integration of rules takes place there will still be differences because the American accounting rules US Generally Accepted Accounting Principles (US GAAP) interpreted different from IFRS. For European countries there still will be barriers in the capital market since America has the world's largest capital market. This means that the annual report of stocks listed in an American company have to be redone according to American accounting principles.

[1] Dominique Rachez Ernst & Young, Lecture Karlstad University, 15 September 2009

The Generally Accepted Accounting Principles (GAAP) is known as a national concept and is common in almost every country in Western Europe and USA. These principles are called US GAAP, UK GAAP and Swedish GAAP.[2]

Development of IASC- International harmonization

The formation of IASC was related to the International Federal of Accountants (IAFC) which is a global accountancy organization. The development of IAFC has a purpose of harmonized standards of the worldwide accountancy profession. Later on the IAFC developed to IASC and the members automatically became members under IASC. The IASC started because of its existence in knowledge and its standard without authorities. In 1989 IASC published Exposure Draft, to be able to approach more proactive. Over the years they compared the earlier versions of the standards which showed that the IAS had gotten more meaningful and significant. The development of IASC continued and collaboration with the International Organisation of Securities Commissions (IOSCO) was made to fulfill a "core set" of IAS, 1999. This collaboration agreement is of a great importance because it would mean that a set of financial reports is prepared with IAS GAAP. Therefore, listing purposes without both changes and reconciliation to national GAAP has its impact on every important exchange in the world stocks. On worldwide level this saves resources for both users and analysts. If organs other than the standard setter would have the role of international standard setters small and medium-sized entities would without a doubt disappear.

In 1999 IASC took its place as a global accounting standard setter and made some significant structure changes. (Alexander 2009)

Swedish Accounting Standards

According to the law the accounting in Sweden has to be made with GAAP, 4 chapter. 2§ accountancy law (BFL), 2 chapter. 2§ annual report law (ÅRL). In Sweden it is unclear what GAAP stands for when it comes to different types and sizes of Swedish companies. It also is impossible to choose between IFRS or The Swedish Financial Accounting Standards Councils recommendations if you belong in the category of large non-listed companies. As we already know IFRS is compulsory for consolidated companies in the consolidated accounting and can also become governing for parent companies.

In certain cases the legal person that is included in a consolidate that applies the IFRS standards can differ from the principals in the consolidate accounting. The main reason for this occurrence depends on the connection between accounting and taxes, which is of a great importance in Sweden.

[2] Stefan Olsson Associate Professor, Lecture at Karlstad University, 11 September 2009

Different Accounting systems

Differences in accounting systems depend on environment, cultural differences and economics. Similar environment means similar accounting systems while legal and political environment means different accounting systems. Accountants have a major role today because they fulfill their task properly. Accountants get signed up by shareholders to check the communication process, financial reporting process and the outcome of the company. The government often uses the financial report for their own purpose in countries with code law. For countries who serves the government the annual account often is used for tax purposes. While there in some countries use the financial report to information needs of the government. Therefore we can say that there are two types of accounting regulations. At first we have accounting regulations in countries with a private sector, USA, UK, Australia and Netherlands. These countries have a common law system because the private standard settings and the shareholder orientation works together. Secondly, there are countries with accounting regulations where the government has a major part. These types of regulations can be observed in many European countries where the accounting rules can be found in the company law. Both of these mentioned accounting regulations apply to non-listed groups and SMEs.

Even though all companies implement US GAAP or IAS/IFRS the quality of the financial report in different countries will still be affected by national influences. A whole lot of the research that has been done is based on financial information with a basis of IFRS. There are still researching whether accounting quality differs among countries where listed companies comply with IFRS as basis.

In EU some states have extended IAS/IFRS while some has IAS/IFRS on a voluntary basis for financial institutions, group accounts for listed companies and individual accountants. This leads to replacement of statements which actually should have been prepared to national GAAP. In some states it is forbidden to prepare the individual accounts according to IAS/IFRS, Austria, Belgium, France, Spain and Sweden. Now days more countries are using IAS/IFRS but in some countries the IAS/IFRS is identical to national GAAP. IFRS for listed group is getting compulsory and the worldwide use of IAS/IFRS will decrease. To achieve the worldwide use of IAS/IFRS or a so called global accounting standard an agreement from the American SEC (Securities and Exchange Commission) is necessary about reconciliation against US GAAP. It is believed that the American SEC in time will allow US to use IFRS in their financial statement without any reconciliation to US GAAP. (Alexander 2009)

Development of SMEs

As mentioned the International Financial Reporting Standards for small and medium – sized entities (IFRS for SMEs) were published 9th July 2009 by IASB. The publish of the IFRS for small and medium-sized entities means that original exposure draft (ED) has made the standards simplified in order to reflect the responds. Therefore, only entities that don't have a public accountability will be able to apply the IFRS for SMEs regardless from the entity size. (McQuaid 2009) The IFRS for SMEs is a stand-alone standard unlike from all the accounting policies in full IFRS that had been permitted by the Exposure Draft with cross-references to IFRS. Because IFRS for SMEs is a stand-alone standard there are no cross-references to full IFRS, therefore some simplifications and further guidance have been made in order to avoid cross-references. The simplification of measurement and recognition that has been made in IFRS for SMEs can be seen in two sections, section *11 Basic Financial Instruments* and section *12 Other Financial Instrument Issues.* (Sealy-Fisher 2009)

IFRS for SMEs gives enterprises a definition that follows (European Commission 2006).

"Any entity engaged in an economic activity, irrespective of its legal form".

During the Exposure Draft a field test was made of the IFRS for SMEs with 116 small entities from 20 countries. Of these entities 35 percent had 10 or less fulltime employees while another 35 percent had among 11 and 50 fulltime employees. Of these field tests you could conclude that more than half of the entities had bank loans or overdrafts, while a third had foreign operations. The Entities that took a part of the field test was required to repeat their most recent annual financial statement and identifying the problems that they met during the procedure. Through these rapports some important changes was made in the Exposure Draft. (Patcher 2009)

The simplification has been made on that some complex parts of the full IFRS has been reduced by IASB while some parts are referred to full IFRS. Some of the parts that have been reduced are the following:

- Proportionate consolidation
- Property, plan equipment and intangible assets revaluation
- Borrowing costs has to fulfill a particular criteria
- Development cost has to fulfill particular criteria
- Guidance of the linear method to compensate expected inflation (McQuaid 2009)

The reason for IFRS for SMEs was to reduce the cost of capital by increasing the quality of financial reports while the value of the firm would increase. With these advantages there were no consideration taken about how this would affect IFRS since most of the companies are unlisted. The new definition of IFRS for SMEs was important because it would for some unlisted companies mean that they had to follow the new standard. From the beginning IASB made it clear that the new standard, IFRS for SMEs should be used by capital markets and quoted companies. (Jarvis 2003)

IFRS SME

International financial reporting standards for small and medium-sized entities (IFRS for SMEs) were published 9th July 2009 by IASB. Small and medium-sized entities are of great importance because they represent more then 95 percent of all the companies in the world. The development process of the standard took five years with extensive consultation from worldwide SMEs. (IASB 2009a)

IFRS SME is a standard of 230 pages that is helpful to small companies with their needs and capabilities. The IFRS for SMEs is based on full IFRS, the changes that has been made is simplified and omitted ways of both recognizing and measuring assets, liabilities, revenues and expenses.

The IFRS for SMEs is simpler than full IFRS, which makes it easier to get responds from the international demand from as well developed and emerging economics. For growing businesses full IFRS is often necessary and the IFRS for SMEs will also be available. Because the IFRS for SMEs is separate from full IFRS it will be possible for any authority to implement IFRS for SMEs even though no implement of IFRS has been made.

Therefore the benefit with the IFRS for SMEs will create ability to:

- easier compare accounts for users
- accounts of small and medium-sized entities to increase the overall confidence
- reduce costs of maintaining standards on a national basis (IASB 2009b)

Small and medium-sized entities can be defined by looking at three criteria; number of employees, annual turnover and annual balance sheet. One criteria that has to be fulfilled is the one that covers numbers of employees while only one of the other two criteria has to be fulfilled. By that, if only one criteria of annual turnover and annual balance sheet is fulfilled it means that the company will retain their status as a SMEs. (Bip Solutions 2005)

To be defined as a medium-sized entity there should be fewer than 250 employees, the annual turnover shall not exceed 50 million euro or the annual balance sheet shall not exceed 43 million euro. If we now have a look at small enterprises there should be fewer then 50 employees, the annual turnover or the annual balance sheet shall not exceed 10 million euro. Last we have the micro enterprises which should have fewer than 10 employees, the annual turnover or the annual balance sheet shall not exceed 2 million euro. (European Commission 2006) This is explained by the table below:

Enterprise category	Headcount: Annual Work Unit (AWU)	Annual Turnover	Annual balance sheet total
Medium-sized	< 250	≤ € 50 million (1996 € 40 million)	≤ € 43 million (1996 € 27 million)
Small	< 50	≤ € 10 million (1996 € 7 million)	≤ € 10 million (1996 € 5 million=
Micro	< 10	≤ € 2 million (previously not defined)	≤ € 2 million (previously not defined)

Tabell 1: European Commission (2006). s. 14

However, small and medium-sized entities don't have public accountability which means that the trade of debt or equity occurs in a public market or in the process of filing. Even the assets aren't hold as they would have been if they belonged to the primary businesses. The general purpose of the financial statements is also published by the small and medium-sized entities. Therefore the financial statements objective is to give information about the financial position, performance and cash flows that is useful to make an economic decision and understood by users who don't have opportunity to particular information that requires permission. The users of financial information are banks, suppliers, customers, rating agencies and shareholders.[3]

Full IFRS and IFRS for SMEs

If we start looking at the IFRS it covers a wide amount of issues because it is formed to meet the needs of equity investors in companies in public capital markets. This standard implements both guidance and disclosures for public companies. These needs aren't of that great importance for the users of the financial statements of SMEs, what matters is cash flows, liquidity and solvency. According to the SMEs it seems to be a lot of pressure from the full IFRS because IFRS is getting more and more detailed. This development of the IFRS depends on implements from more countries. IASB has when developing the IFRS for SMEs a goal to meet both balancing costs and benefits from a larger perspective. (IASB 2009a)

[3] Hanno Kirsch, Lecture at Karlstads University, 1 september 2009

If we compare full IFRS with the IFRS for SMEs there are more alternatives for accounting options which means that there is limited accounting knowledge of the SMEs while the trade-off within the framework and cost benefit assessment will be the same.[4]

Another difference that has been made for the IFRS for SMEs is simplifications from full IFRS; there have been a total of five simplifications. The first simplification concerns some parts of full IFRS that has been removed because it doesn't have anything that involves to typical SMEs. The second simplification shows that SMEs have more simplified methods and therefore some of the accounting policies in full IFRS are no longer allowed. The third simplification involves simplification of many principles regarding recognition and measurement. The fourth simplification is about significantly fewer disclosures. The fifth and last one is about simplified redrafting.

As mentioned there are parts that have been reduced from full IFRS when it comes to IFRS for SMEs, by that they are only mentioned in the full IFRS. Four examples of these are: earnings per share, interim financial reporting, segment reporting and special accounting for assets that is for sale. (IASB 2009c)

Full IFRS and national GAAPs are more complex than the IFRS for SMEs, for instance IFRS for SMEs is written in a clear way because it then easily can be translated in different languages. Therefore the IFRS for SMEs is divided in 35 sections. IFRS for SMEs only allows the easier option when full IFRS allows accounting policy choices. When IFRS for SME in July became effective there were considerations taken by jurisdictions about whether IFRS for SME should be required or permitted and also for which entities. In one section of the IFRS for SME there is a requirement of the year an entity adopts IFRS for SME they have to recount previous year's data. (Patcher 2009)

[4] Hanno Kirsch, Lecture at Karlstads University, 1 september 2009

Analysis

As we know, small entities usually run into problems because they don't have enough working capital, investment capital and growth. Often it's believed that this may be related to products or services that an entity has but in this cases it don't have a meaning. The financial reports that are given out have to be truthful and understandable because the lenders, vendors or other capital providers will ask for this in return to help them minimize the risk in their capital- and price decisions. Access to capital is one reason to why IFRS for SMEs will benefit SMEs.

For every section in IFRS for SMEs standard the International Accounting Standards Committee Foundation have developed some training material, in which every section will have comments, examples, cases and quizzes. This material is also published in different languages.

During two years after the implement of IFRS for SMEs, IASB are planning to review the experiences and financial statements over a wide area of entities. However, the meaning with this review is to get an overhaul and suggest changes to the issues that occurred with the implementation. This will also led to that IFRS and the IFRS for SMEs will be followed up, the new and improved IFRS will be taken in consideration. This review that is expected will be improved by the board and therefore the IFRS for SME will be published in a collection of Exposure Draft every third year. (Patcher 2009)

The basic idea with international accounting standards is to understand and achieving a harmonization of the accounting which therefore will help to compare accounts between different countries. In different countries application of different accounting policies is chosen, which makes it harder for an effective allocation of resources in companies where the capital is used mostly effective. (Sundgren 2007) However, to achieve this global harmonization an agreement from the US GAAP is needed, which is mentioned in the theoretical part. As we already know research shows that US in the future will agree and hopefully a global accounting standard will be achieved.

The IFRS for SMEs that is developed by IASB contains simplified accounting rules for entities that don't have a public accountability, and therefore needs all responses they can get because it is a new standard that has been implemented. To get the response from entities that are using the IFRS for SMEs the IASB had organized some meetings to find out responses and interested parties. (McQuaid 2009)

The reason why a special accounting standard for SMEs, the IFRS for SMEs, has been developed is because the users of SMEs ask for different information than public

companies that uses financial statements. This is one of the reasons why IASB has developed this standard for small and medium-sized entities.
IASB has a main goal and that is to develop one international accounting standard. As mentioned there only are some countries that require the full use of IFRS. To achieve a global application of the accounting standards, IASB have to satisfy the accounting information that the stakeholders request of small and medium-sizes entities. The IFRS for SMEs project is about developing accounting standards for specifically SMEs which can be interpreted as accounting standards for SMEs will be customized by the organization. However, this need reflect on creditors and the state rather than on investors because they represent SMEs largest stakeholders. This means that the accounting standards for SMEs may allow more conservative valuation than what the case would have been if it concerned to the application of full IFRS. IFRS for SMEs have also been developed because full IFRS is considered being to complicated and expensive for small and medium-sized entities. In many cases the costs of applying full IFRS is higher than the economic benefits for small and medium-sized entities. This does not mean that the full IFRS won't be available to apply. Full IFRS is at all times available for reporting entities.

In some countries listed companies report with IFRS while other unlisted small and medium-sized entities report with national GAAP. The disadvantages with different reporting standards are that a comparison between these accounting reports creates problem for stakeholders. It is important for both lender and investors to be able to compare listed companies accounts with unlisted small and medium-sized entities, because they want to make so effective allocation decisions as possible. However, even the state would like to be able to compare the different entities performing and acts so they can se if they provide a fair and legal accounting. The advantage with a harmonization of accounting standards on a global level is to ensure and improve comparability between different organizations financial statements.

Because the IASB are aware that the implementation of the IFRS reduces the opportunity to compare different company accounts, they are trying to minimize this through an implementation of IFRS for SMES. Because IFRS rapidly is increasing the IFRS for SMEs are built on full IFRS that will help to harmonize the accounting standards. This will in time lead to a harmonization of IFRS and national GAAP, which means that an adaption to IFRS for SMEs national accounting standards has been made. Often countries with national GAAP have the accounting standards for SMEs included in their national GAAP or national law.

Conclusions

The purpose with this paper was to compare full IFRS with IFRS for SMEs and thereby find out the reason for development of the international accounting standard, the IFRS for SMEs.

The main reason why IASB developed the standard for SMEs, reflects on the interest that there seems to be among small and medium-sized entities. These small and medium-sized entities financial reports are less complicated and expensive compared to the application of full IFRS. This global implement of the IFRS for SMEs and the increased use of IFRS have resulted to less comparability between listed and non-listed companies. Therefore, a harmonization of the international accounting standards, both IFRS and the IFRS for SMEs will have a positive affect because the requirement of comparability is increasing. In other words, we can say that the IFRS for SMEs can be interpreted as the next step towards the process of harmonization of international accounting standards.

Although, more companies reports under IFRS there still are companies that follow the national GAAP and thereby the comparability between these companies will not be available. That is why a harmonization of national GAAP has to be done for IFRS for SMEs. Therefore, it is important that IASB takes this matter into their own hands and as soon as possible try to develop a harmonized regulatory for SMEs to avoid larger varieties of national GAAP. The main goals with the IFRS for SMEs today are therefore; to develop one international accounting standard, to satisfy the accounting information that the stakeholders request of small and medium-sizes entities, to base the standards on the same framework as IFRS and at last to reduce the reporting burden for SMEs.

The development of a harmonized regulatory doesn't seem to be included in the IFRS for SMEs according to today's case, but hopefully it will become being a more considerate goal in the future.

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