

# *Simplifying reporting – Moving to SME accounting*

*Private Company  
Services – Providing an  
overview of the IFRS  
for SMEs and matters  
to consider on its  
implementation*

*May 2012*



## Introduction

The International Financial Reporting Standard for Small and Medium-sized entities (the IFRS for SMEs) was developed by the International Accounting Standards Board (IASB) in recognition of the difficulty and cost to private companies of preparing financial statements that are compliant with full IFRS.

The IFRS for SMEs recognises that the users of private entity financial statements may have a focus that is different from that of users of the financial statements of listed or other publicly accountable entities.

## The end of SA GAAP

The Accounting Practices Board (APB) and the Financial Reporting Standards Council (FRSC) issued a joint communication during March 2012 reflecting their decision to discontinue the use of SA GAAP. Effective from annual periods commencing on or after 1 December 2012, companies are no longer allowed to apply SA GAAP.

Companies currently applying SA GAAP therefore need to consider the financial reporting framework that will be appropriate for them to apply in future - the choice: **IFRS or the IFRS for SMEs**

In making this choice, entities need to consider matters such as whether they intend listing in the future, whether they form part of a larger group of companies which report under IFRS and what their stakeholders' expectations around reporting might be. On the other hand, entities that are seeking a more stable platform which may require a smaller investment in keeping financial staff up to date and which may result in lower costs in preparing financial statements may be more interested in IFRS for SMEs.

You may find the section titled 'Why entities are making the change' on page 6 of this publication useful to demonstrate the benefits of applying the IFRS for SME standard, and the section on pages 2-4 showing the key differences between IFRS and IFRS for SMEs, it is useful as a guide to understanding the additional complexity that full IFRS brings. When a company decides to move from SA GAAP to IFRS, the company will need to consider IFRS 1 - First time adoption of IFRS. While there are minimal differences between SA GAAP and IFRS, IFRS 1 requires certain disclosures to be made by the company when converting to IFRS in its first set of IFRS financial statements. In addition, there are decisions to be made by management on the exemptions under IFRS 1 that the company may wish to elect.

Companies should consult further with their PwC contact should they wish to move from SA GAAP to IFRS. The rest of this document focuses on moving from SA GAAP to IFRS for SME's.

## Who can apply the IFRS for SMEs

In terms of the Companies Act No. 71 of 2008 ("The Act"), which came into effect on 1 May 2011, the following financial reporting frameworks are permitted to be applied:

- IFRS
- IFRS for SMEs
- SA GAAP

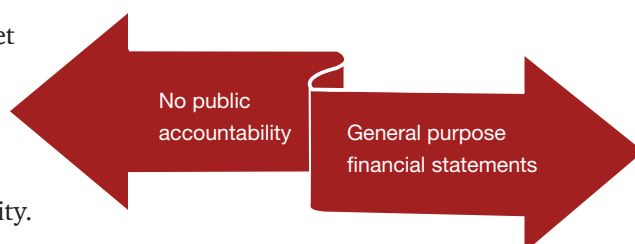
All entities apart from public companies, state-owned companies and certain non-profit companies are allowed to apply the IFRS for SMEs, subject to meeting the scoping requirements of the standard.

## Scope of the IFRS for SMEs

The IFRS for SMEs is aimed at entities that:

- do not have debt or equity instruments traded in a public market
- do not hold assets in a fiduciary capacity for a broad group of outsiders, and
- prepare general purpose financial statements.

The first two bullets relate to entities that have public accountability.



## What are the key differences between IFRS and the IFRS for SMEs

	IFRS	IFRS for SMEs
<b>Financial Statements</b>	A statement of changes in equity is required, presenting a reconciliation of equity items between the beginning and end of the period.	There is a similar requirement, with a relief provision which states that if the only changes to equity during the period are as result of profit or loss, payment of dividends, correction of prior-period errors or changes in accounting policy, a combined statement of income and retained earnings can be presented of both a statement of comprehensive income and a statement of changes in equity.
<b>Business combinations</b>	<p>Transaction costs are excluded under IFRS 3 (revised).</p> <p>Contingent consideration is recognised regardless of the probability of payment.</p>	<p>Transaction costs are included in the acquisition costs.</p> <p>Contingent considerations are included as part of the acquisition cost if it is probable that the amount will be paid and its fair value can be measured reliably.</p>
<b>Investments in associates and joint ventures</b>	<p>Investments in associates are accounted for using the equity method.</p> <p>The cost and fair value model are not permitted except in separate financial statements.</p> <p>To account for jointly controlled entities, either the proportionate consolidation method or the equity methods are allowed.</p>	<p>An entity may account for its investments in associates or jointly controlled entities using one of the following:</p> <ul style="list-style-type: none"> <li>• The cost model (cost less accumulated impairment losses)</li> <li>• The equity method</li> <li>• The fair value through profit or loss model</li> </ul>
<b>Expense recognition</b>	<p>Research costs are expensed.</p> <p>Development costs are capitalised and amortised when specific criteria are met.</p> <p>Borrowing costs are capitalised if certain criteria are met.</p>	All research and development costs and all borrowing costs are recognised as an expense.
<b>Financial instruments – derivatives and hedging</b>	<p>IAS 39, 'Financial Instruments: Recognition and measurement', distinguishes four measurement categories of financial instruments:</p> <ul style="list-style-type: none"> <li>• financial assets at fair value through profit or loss</li> <li>• held to maturity investments</li> <li>• loans and receivables, and</li> <li>• available-for-sale financial assets.</li> </ul>	<p>There are two sections dealing with financial instruments:</p> <ul style="list-style-type: none"> <li>• A section for simple payables and receivables and other basic financial instruments</li> <li>• A section for other, more complex financial instruments.</li> </ul> <p>Most of the basic financial instruments are measured at amortised cost; the complex instruments are generally measured at fair value through profit or loss.</p>

## What are the key differences between IFRS and the IFRS for SMEs

	IFRS	IFRS for SMEs
<b>Non-financial assets and goodwill</b>	For tangible and intangible assets, there is an accounting policy choice between the cost model and the revaluation model.	The cost model is the only permitted model.
<ul style="list-style-type: none"> <li>• <b>Tangible and intangible asset</b></li> </ul>	Goodwill and other intangibles with indefinite lives are reviewed for impairment and not amortised.	All intangible assets, including goodwill, are assumed to have finite lives and are amortised.
<ul style="list-style-type: none"> <li>• <b>IAS 38, 'Intangible Assets'</b></li> </ul>	The useful life of an intangible asset is either finite or indefinite. The latter are not amortised and an annual impairment test is required.	There is no distinction between assets with finite or infinite lives. The amortisation approach therefore applies to all intangible assets. These intangibles are tested for impairment only when there is an indication.
<ul style="list-style-type: none"> <li>• <b>IAS 40, 'Investment Property'</b></li> </ul>	Entities have an accounting policy choice between the fair value and cost method.	Investment property is carried at fair value if this fair value can be measured without undue cost or effort.
<ul style="list-style-type: none"> <li>• <b>IFRS 5, 'Non-current assets held for sale and discontinued operations'</b></li> </ul>	IFRS 5 requires non-current assets to be classified as held for sale where the carrying amount is recovered principally through a sale transaction rather than through continuing use.	There is no separate standard dealing with this. The decision to sell an asset is considered an impairment indicator.
<b>Employee benefits – defined benefit plans</b>	<p>Actuarial gains or losses can be recognised immediately or amortised into profit or loss over the expected remaining working lives of participating employees.</p> <p>The use of an accrued benefit valuation method (the projected unit credit method) is required for calculating defined benefit obligations.</p>	<p>Actuarial gains or losses require are recognised immediately and splits the expense into different components.</p> <p>The circumstance-driven approach is applicable, which means that the use of an accrued benefit valuation method (the projected unit credit method) is required if the information that is needed to make such a calculation is already available, or if it can be obtained without undue cost or effort. If not, simplifications are permitted in which future salary progression, future service or possible mortality during the employee's period of service are not considered.</p>

## What are the key differences between IFRS and the IFRS for SMEs

	IFRS	IFRS for SMEs
<b>Income Taxes</b>	<p>A deferred tax asset is only recognised to the extent that it is probable that there will be sufficient future taxable profit to enable recovery of the deferred tax asset.</p> <p>No deferred tax is recognised upon the initial recognition of an asset.</p> <p>There is no specific guidance on uncertain tax positions. In practice, management will record the liability measured as either a single best estimate or a weighted average probability of the possible outcomes, if the likelihood is greater than 50%.</p>	<p>A valuation allowance is recognised so that the net carrying amount of the deferred tax asset equals the highest amount that is more likely than not to be recovered. The net carrying amount of deferred tax asset is likely to be the same between full IFRS and IFRS for SMEs.</p> <p>No such exemption.</p> <p>Management recognises the effect of the possible outcomes of a review by the tax authorities. This is measured using the probability-weighted average amount of all the possible outcomes. There is no probable recognition threshold.</p>

### Transition to the IFRS for SMEs

Transitioning to the IFRS for SMEs entails the first time adoption of the accounting framework and the discontinuance of the previous GAAP applied by the entity.

### What guidance is available for the transition?

The IFRS for SMEs sets out the transition principles to be applied in Section 35 when an entity prepares its first set of financial statements in which an unreserved and explicit statement of compliance is made.

The transition to IFRS for SMEs starts with the preparation of an opening statement of financial position as at the “date of transition to the IFRS for SMEs”. This date is the beginning of the earliest period for which the entity presents full comparative information in accordance with the IFRS for SMEs.

### What entities must do

- Recognise all assets and liabilities required to be recognised by IFRS for SMEs
- Derecognise all assets and liabilities not permitted by IFRS for SMEs
- Reclassify any items that should be classified differently under IFRS for SMEs
- Align accounting policies which differ from those under IFRS for SMEs and make a cumulative adjustment to equity.

## What should transitioning entities disclose?

Entities are required to disclose how the transition has affected the entity's reported financial position. To achieve this, the entity shall disclose:

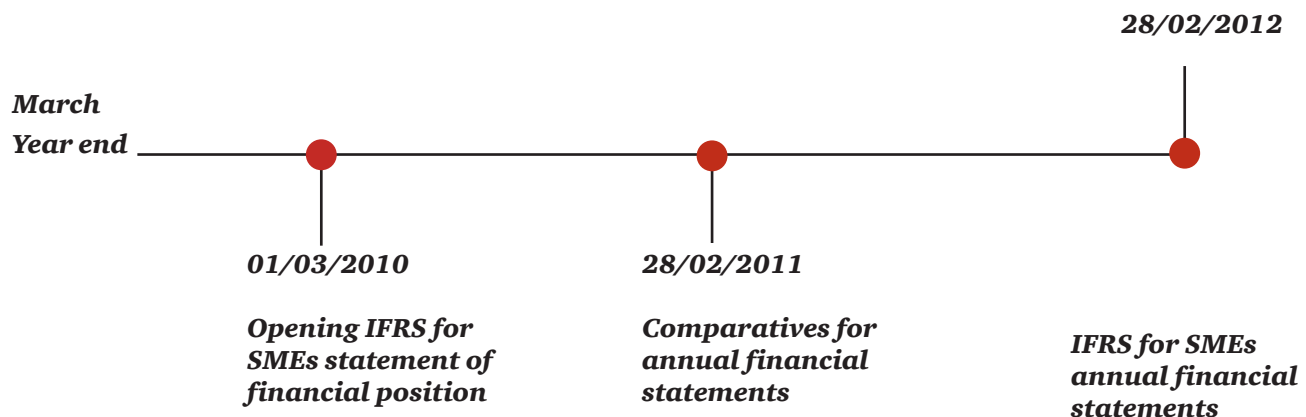
- a description of the nature of each change in accounting policy;
- a reconciliation between its equity determined under the previous framework and equity determined under IFRS for SMEs for both –
  - the date of transitioning to IFRS for SMEs, and
  - the end of the latest period presented in accordance with the entity's previous framework.
- a reconciliation of profit or loss determined in accordance with its previous framework for the latest period presented to the IFRS for SMEs based profit for the same period.

## Is there relief from retrospective restatement?

- Entities shall not restate financial statements for several items such as derecognition of financial assets and liabilities, hedge accounting, accounting estimates, discontinued operations and the measurement of non-controlling interests.
- Moreover, entities may elect to apply several available exemptions which relate to, inter alia, business combinations, share-based payments and cumulative translation differences.

## Illustration of the relevant periods affected

The timeline below sets out the key dates for an entity that plans to issue its first set of IFRS for SMEs compliant financial statements for the year ended 28 February 2012.



## Why entities are making the change?

Simplified recognition and measurement principles

Generally less complex accounting with fewer options

Fewer disclosures (especially financial instruments and construction contracts)

Lower costs involved in preparing financial statements

More convenient to have a single standard with sub-sections as opposed to separate standards

No interpretation notes to keep track of

Less frequent changes as the IASB proposes to amend the IFRS for SMEs only once every three years

Plain english

Circumstance-driven approach to financial reporting

Undue cost or effort exemption in certain circumstances

## Frequent questions from clients

### Q: Will it cost less to apply the IFRS for SMEs?

This will depend largely on the complexity of the operations of the client and whether the client previously needed extensive disclosure in terms of standards such as IFRS 7 (Financial Instruments: Disclosure) and IAS 19 (Employee Benefits). Many sections and disclosures have been simplified, which may lead to audit efficiencies and lower the cost of compliance with the financial reporting framework of the entity.

### Q: Is there a downside compared with applying full IFRS?

Applying the IFRS for SMEs must be carefully considered by subsidiaries, associates and joint ventures of investors that report in terms of full IFRS, due to the fact that accounting policies must be aligned when the investor reports its consolidated/combined results.

## Tools available for the IFRS for SMEs

- Questions and Answers for the IFRS for SMEs
- PwC IFRS for SMEs Topic Summaries
- PwC IFRS for SMEs Pocket Guide
- PwC 'e-check' disclosure checklist for the IFRS for SMEs
- PwC IFRS for SMEs webcast series
- PwC Illustrative IFRS for SMEs Consolidated financial statements
- Similarities and difference: A comparison of 'full IFRS' and IFRS for SME's.

## Other tools available for the IFRS for SMEs

- Training modules for the IFRS for SMEs (released by the IASB)
- IASB presentation on IFRS for SMEs

All of the listed tools and publications are available under the "Accounting and corporate reporting" section of PwC Inform which can be accessed at [www.pwcinform.com](http://www.pwcinform.com)



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