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Applying
IFRS[®]
for
SMEs

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FOREWORD

Small and medium-sized entities (SMEs) pervade the business world. In virtually every jurisdiction, from the largest economies down to the smallest, over 99% of companies has fewer than 50 employees.

In most jurisdictions, the law requires all or many of these companies to prepare financial statements and, often, to have them audited. In the European Union alone, for example, over five million of the 21 million business entities have a statutory reporting obligation.

WHY AN IFRS FOR SMEs IS NEEDED

Which accounting standards do SMEs follow in preparing their financial statements? The global trend, in the past decade, has been for jurisdictions to adopt International Financial Reporting Standards (IFRS) directly, or to merge their local standards with IFRS. For listed companies today, over 110 jurisdictions mandate IFRS. IFRS is designed to meet the needs of public capital markets, and consequently address complex transactions, provide extensive detailed guidance, include a range of fair value and present value measurements, and require thousands of disclosures, many intended to meet the needs of long-term equity investors. The 2009 bound volume of IFRS has grown to 2,855 pages.

In many jurisdictions, this complexity has been pushed down to SMEs due to convergence of local accounting standards and IFRS, or direct adoption of IFRS. Small companies frequently say they find full IFRS burdensome—the resulting financial statements are off-target in terms of the users of their financial statements who are more interested in information about short-term cash flows, liquidity, and solvency.

South Africa is a perfect case in point. In October 2007, following a period of consultation, the Accounting Practices Board (APB) of the South African Institute of Chartered Accountants (SAICA) adopted the International Accounting Standards Board's (IASB), then-proposed IFRS for SMEs as a final (though intentionally interim) Statement of Generally Accepted Accounting Practice (GAAP) for SMEs. Why? By 2007, South African GAAP had become fully converged with IFRS, and many SMEs were struggling to use those standards. They found them burdensome and too complex for their needs. A change in South African company law earlier in 2007 had made provisions for differential reporting for limited interest companies (SMEs), and SAICA acted on it.

WHAT HAS BEEN THE TAKE-UP OF THE IFRS FOR SMEs SO FAR?

The Standard was issued in July 2009. A survey of world accounting standard setters conducted in September found that, of 51 responding jurisdictions, 31 plan to require or permit the IFRS for SMEs within the next three years, 11 have no plans to do so, and nine are undecided. Since that survey, at least half-a-dozen additional countries have announced plans to adopt it.

Many global accounting groups welcomed the IFRS for SMEs when it was issued in July. The World Bank said it is a “valuable reporting framework for smaller entities that is more responsive to the size and ownership of their operations, and should help improve their access to finance.” And, the International Federation of Accountants said the Standard “will contribute to enhancing the quality and comparability of SME financial statements around the world and assist SMEs in gaining access to finance. The beneficiaries will be not only SMEs, but also their customers, clients, and all other users of SME financial statements.”

Those kinds of benefits are the reasons why the IASB developed the Standard. An important public interest is served when those who provide capital have good information on which to base their lending, credit, and investment decisions. The IFRS for SMEs will bring those benefits to South Africa and the rest of the world.

Paul Pacter
IASB Board Member
Director of Standards for SMEs
International Accounting Standards Board
London
November 2010

PREFACE

Applying IFRS for SMEs is based on the International Financial Reporting Standards for Small and Medium-Sized Entities (IFRS for SMEs or the Standard) as issued by the International Accounting Standards Board in June 2009. The book is a comprehensive review of the Standard, providing the principles and guidance contained in the Standard. It has been written by subject matter experts, training, and applying the Standard in practice.

The publication can be used by practitioners and preparers applying IFRS for SMEs, as well as for academic purposes.

The aim of Applying IFRS for SMEs is to assist in the application of the Standard in practice and to provide insights on certain interpretative issues. This is achieved by:

- Examples showing certain transactions and events.
- Figures illustrating more complex issues in the form of a diagram.
- Tables providing lists and points.
- Our insights and opinions on the appropriate treatment for certain transactions and events.
- Extracts from the IFRS for SMEs and full IFRS.
- Highlights of main points.
- Comparisons to Exposure Draft (a.k.a., the Exposure Draft of a Proposed IFRS for SMEs).
- Comparisons to full IFRS.
- A summary of the major points at the end of each chapter.

LIST OF ABBREVIATIONS

APB	The Accounting Practices Board
CGT	Capital gains tax
CGU	Cash-generating unit
CU	Currency unit
EUR	Euro
FCTR	Foreign currency translation reserve
FIFO	First-in-first-out
Framework	IASB's Framework for the Preparation and Presentation of Financial Statements
FV	Fair value
GAAP	Generally Accepted Accounting Principles
GBP	Great Britain Pound Sterling
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee
IFRS (Full IFRS)	International Financial Reporting Standards
IFRS for SMEs	International Financial Reporting Standard for Small and Medium-Sized Entities
IRR	Internal rate of return
JIBAR	Johannesburg Interbank Agreed Rate
JV	Joint venture
LIBOR	London Interbank Offered Rate
LIFO	Last-in-first-out
NCI	Non-controlling interest
OCI	Other comprehensive income
P/L	Profit or loss
PPE	Property, plant, and equipment
SCF	Statement of cash flows
SCI	Statement of comprehensive income
SFP	Statement of financial position
SIC	Standard industrial classification
SIRE	Statement of income and retained earnings
SME	Small and medium-sized entity
SPE	Special purpose entity
The Standard	IFRS for SMEs
USD	United States Dollar
YEN	Japanese Yen
ZAR	South African Rand

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1 SCOPE OF THE IFRS FOR SMEs

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GENERAL SCOPE

The IFRS for Small and Medium-Sized Entities (IFRS for SMEs, “the Standard”) is an independent standard that prescribes financial reporting guidance for small and medium-sized entities (SMEs). The Standard is applicable to SMEs that:

- Do not have public accountability
- Publish general purpose financial statements for external users

The Standard does not provide any quantitative measures, such as revenue, expenditure, assets, or number of employees, to determine whether or not the Standard may be used. The Standard states that each jurisdiction needs to determine which entities may apply the IFRS for SMEs.

DEFINITIONS

General Purpose Financial Statements

General purpose financial statements are defined as financial statements aimed at the general financial information needs of a wide range of users who are not in a position to demand reports tailored to meet their particular information needs.

The IFRS for SMEs allows general purpose financial statements to be published for external users, including:

- Owners who are not involved in managing the business
- Existing and potential creditors
- Credit rating agencies

Public Accountability

An entity has public accountability if:

- Its debt or equity instruments are **traded in a public market** or it is in the process of issuing such instruments for trading in a public market.
- It holds assets in a **fiduciary capacity** for a broad group of outsiders as one of its primary businesses.

Meeting any one of the above two requirements is regarded as public accountability, which results in an exclusion from the scope of the Standard.

Traded in a Public Market

Publicly traded is defined in the Standard as ‘registered with a securities commission or other regulatory organization for the purpose of sale in a public market.’ Public accountability is not only when an entity’s debt or equity instruments are actually traded in a public market, but also when the entity is in the process of issuing such instruments for trading in public markets.

The Standard states that public markets include domestic or foreign stock exchanges or over-the-counter markets, whether local or regional.

Entities whose memorandum of incorporation or other incorporation documentation allows for the offering of any of its securities to the public will not be regarded as having public accountability until they actually start taking steps to issue such instruments for trading in a public market.

The Standard is not intended for small publicly-traded entities. Due to the special needs of capital markets, the use of full IFRS is required for small publicly-traded entities. All entities whose debt or equity instruments are traded in public capital markets, regardless of size, have chosen to seek capital from outside investors. Usually, these investors are not involved in the management of the business and are not in a position to demand specific information. Full IFRS is developed to serve the capital markets, and with this in mind, require specific disclosures, which may not be included in the IFRS for SMEs.

Fiduciary Capacity

To be excluded from the scope of the Standard, entities must hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. The requirement *as one of its primary businesses* is essential. Some entities may hold assets in a fiduciary capacity because they hold and manage financial resources entrusted to them by clients, customers, or members not involved in the management of the entity. However, if they do so for reasons incidental to their primary business, they are not considered to be publicly accountable—they can apply the Standard.

The Standard provides the following examples of entities that are excluded from the scope of the IFRS for SMEs because they hold assets in a fiduciary capacity:

- Banks
- Credit unions

- Insurance companies
- Securities' dealers
- Mutual funds
- Investment banks

The Standard provides the following examples of entities that may apply the IFRS for SMEs because they hold assets in a fiduciary capacity incidental to their primary business:

- Travel or real estate agents
- Schools
- Charitable organizations
- Co-operative enterprises requiring a nominal membership deposit
- Sellers that receive payment in advance of delivery of goods or services (e.g., utility companies)

EXAMPLE 1.1***Purchase of an Asset Management Company***

Soweto is the holding company of a diverse group of entities. Currently, the Soweto Group has no public accountability as defined. The board of directors recently had their quarterly strategy meeting. As a result, the financial director had various questions about the application of the IFRS for SMEs.

The board of directors identified a small asset management company for possible acquisition that will provide them with various strategic options in the future.

The financial director is uncertain if the asset management company will be able to apply the Standard and, if not, what the implication would be for the consolidation process of the Soweto group.

Required

Provide the financial director with advice in regard to applying the Standard with reference to the possible acquisition and its implications on the Soweto group.

Suggested Solution

The asset management company receives funds, then invests them on behalf of its clients for a fee. The asset management company therefore has public accountability as it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

With respect to the Soweto group, as one of its subsidiaries will not be eligible to apply the IFRS for SMEs, the group can therefore not apply the Standard in its consolidated accounts either.

APPLICATION TO SUBSIDIARY COMPANIES

A subsidiary whose parent uses full IFRS, or that is part of a consolidated group that uses full IFRS, is allowed to use the IFRS for SMEs in its own financial statements provided that it does not have public accountability.

EXAMPLE 1.2

Acquisition by an International Investment Entity

The current shareholders of Berlin were approached by an international investment company regarding a possible purchase of a majority shareholding in Berlin.

The financial director has concerns—the international investment company is currently applying full IFRS as its financial reporting framework; Berlin uses the IFRS for SMEs. He is uncertain if Berlin would be allowed to continue applying the IFRS for SMEs if its potential new holding company does not apply the IFRS for SMEs.

Required

Provide the financial director with advice on applying the IFRS for SMEs and the implications of consolidating Berlin.

Suggested Solution

The IFRS for SMEs states that a subsidiary whose parent uses full IFRS, or that is part of a consolidated group that uses full IFRS, is not prohibited from using the IFRS for SMEs in its own financial statements if that subsidiary does not have public accountability.

Berlin may, therefore, continue to apply the IFRS for SMEs in its own accounting records.

Full IFRS requires all entities included in consolidated financial statements to have uniform accounting policies. The international investment company would therefore need to convert Berlin's IFRS for SMEs' financial statements to full IFRS financial statements for consolidation purposes.

APPLICATION BY MICRO-ENTITIES

The IASB states that this standard would be appropriate for all entities without public accountability preparing general purpose financial statements, irrespective of their size. This would include micro-sized entities (with less than 10 employees) and owner-managed businesses. If such an entity prepares financial statements solely to submit to income tax authorities for the purpose of determining taxable income or to a credit provider to obtain finance, such financial statements must not be deemed to be general purpose financial statements.

The guidance in the Standard is clear and concise. The guidance may cover some transactions or circumstances that micro-entities do not typically encounter, but the IASB did not believe that this imposes a burden on such entities. The structure of the Standard will make it easy for micro-entities to identify those aspects of the Standard that are relevant to their circumstances.

The IASB acknowledged that an extensively simplified and brief set of accounting requirements for micro-entities (with general principles of accounting, specific recognition, and measurement principles for only the most basic transactions and limited disclosure requirements) might result in relatively low costs to micro-entities in preparing financial statements. The IASB concluded that such simplified requirements for micro-entities would not meet the aim of general purpose financial statements and might not improve the micro-entities' ability to obtain capital. Therefore, the IASB has not pursued a project to develop such a standard.

SUMMARY

- The IFRS for SMEs is applicable to SMEs that do not have public accountability, and publish general purpose financial statements for external users.
- An entity is deemed to have public accountability if:
 - Its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market.
 - The entity holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.
- The Standard clarifies that where entities hold assets in a fiduciary capacity as an incidental part of their business activities, this does not make them publicly accountable. Entities that fall into this category may include travel agents, schools, or charities.

2 CONCEPTS AND PERVASIVE PRINCIPLES

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OBJECTIVE OF FINANCIAL STATEMENTS OF SMEs

The stated objective of financial statements of SMEs is to provide information about the financial position, performance, and cash flows of the entity that is useful for economic decision-making by a broad range of users, some of who may not be in a position to demand reports tailored to meet their specific needs. (*See Exhibit 2.1*) Such financial statements are commonly referred to as *general purpose financial statements*.

As a further objective, financial statements also show how management has managed the entity's resources.

QUALITATIVE CHARACTERISTICS OF INFORMATION IN FINANCIAL STATEMENTS

Nine qualitative characteristics of information in financial statements are identified in the Standard without ranking them or explaining how the qualitative

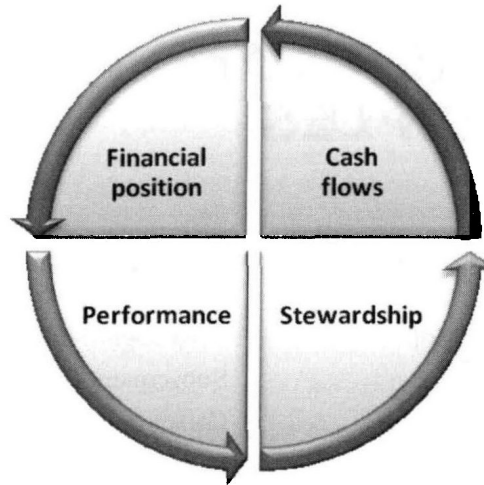


Exhibit 2.1 The Objective of Financial Statements

characteristics relate to each other or identifying some of them as constraints. These qualitative characteristics are:

- Understandability
- Relevance
- Materiality
- Reliability
- Substance over form
- Prudence
- Completeness
- Timeliness
- Balance between benefits and cost

In the detail of the qualitative characteristics and in the discussion of the application of the qualitative characteristics to the development of accounting policies (refer to *Chapter 7*), certain links between the qualitative characteristics are created and certain qualitative characteristics created certain boundaries (also known as constraints). Due to these links and boundaries, certain qualitative characteristics are identified as main or linked qualitative characteristics, and others as constraints in *Exhibit 2.2*.

FINANCIAL POSITION

Basic Principle

The financial position of an entity is the relationship of its assets, liabilities, and equity, at a specific date, as presented in the statement of financial position (SFP) (balance sheet).

Exhibit 2.2 Qualitative Characteristics and Constraints

Main characteristics	Meaning and interpretation	Linked characteristics	Meaning and interpretation
Understandability	Means comprehensibility by potential users with reasonable understanding and knowledge of accounting. This does not mean that information that is difficult to understand may be omitted.		
Relevance	Information is relevant when it is capable of influencing the economic decisions of users. Normally, only material items are relevant, but judgment must be applied to determine which items are immaterial items.	Materiality	Depends on the size of the item and the influence of its omission or misstatement. Omission or misstatement could influence economic decision-making of users of the financial statements.
Reliability	Means free from material error and bias and represents the information faithfully. Faithful representation is created through the linked characteristics of substance over form, prudence, and completeness.	Substance over form	In accordance with the substance and economic reality and not merely the legal form.
		Prudence	Appropriate use of caution in the exercise of judgment.
		Completeness	Complete within the bounds of materiality and cost (refer to the constraints below).
Balance between relevance and reliability (not identified as a qualitative characteristic)	Accounting policies are developed through an appropriate balance between relevance and reliability (refer to Chapter 7).	Timeliness	Provide information in the period of relevance. Balance the relative merit between timely reporting and the provision of reliable information.
Comparability	Financial statements should be consistent from one period to the next, and between different entities.		Goal is to identify trends in financial position, performance, and cash flows.
Boundaries			
Materiality	Depends on the size of the item and the influence of its omission or misstatement.		
Balance between benefits and cost	Benefits must exceed the cost of providing it.		