

IFRS Briefing Sheet

Exposure Draft of an *IFRS for Small and Medium-sized Entities* (SMEs IFRS)

February 2007, **Issue 62**

This IFRS Briefing Sheet summarises the International Accounting Standards Board's (IASB) Exposure Draft (ED) of an *IFRS for Small and Medium-sized Entities* (SMEs IFRS), which was published on 15 February 2007, by focusing on the differences between the proposed SMEs IFRS and existing IFRS requirements (full IFRSs).

- In some areas in which full IFRSs include more than one accounting option, the proposals include the simpler option and cross-reference to full IFRSs for details on applying the more complex option (e.g., SMEs accounting for investment property using the fair value model would refer to IAS 40 *Investment Property*).

The SMEs IFRS is intended to be a stand-alone document organised by topic rather than corresponding to the numbering of full IFRSs. It is intended that the SMEs IFRS will contain significantly less guidance than full IFRSs; therefore, even when the general principles in the proposals appear to be the same as full IFRSs, differences in application may result.

Background and Overview

The SMEs IFRS is intended to facilitate financial reporting by, and to provide accounting standards suitable for, SMEs that want to use international standards.

The Board plans to provide a simplified and slimmed-down version of full IFRSs for SMEs, which has resulted in the following approach in the proposals:

- Transactions that the Board considers less relevant to SMEs are omitted from the ED or are cross-referenced to full IFRSs in the event that such transactions occur (e.g., equity-settled share-based payments).
- Simplifications have been made to the recognition and measurement requirements of full IFRSs in some areas (e.g., there are only two categories of financial assets).

The ED proposes that the SMEs IFRS be updated every two years by the release of an omnibus ED of proposed amendments. Each omnibus ED would consider any new or amended IFRSs that would have been adopted in the two previous years, as well as any issues specific to SMEs that require consideration.

Summary of Proposals

The following summary is not a complete overview of the proposals in the ED, and focuses on recognition and measurement except in respect of disclosure-based standards. Only

**A supplement to KPMG's
publication IFRS in Brief**

AUDIT ■ TAX ■ ADVISORY

significant differences between the proposals and full IFRSs are included in the summary, but the summary does not repeat the requirements of full IFRSs.

Scope and Definition

The ED proposes that SMEs be defined as entities that publish general purpose financial statements for external users and that do not have public accountability. An entity would have public accountability if it files (or is in the process of filing) financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market, or if it holds assets in a fiduciary capacity for a broad group of outsiders (e.g., a bank or insurance company).

There would be no quantitative thresholds in order to qualify as a SME. While the basis for conclusions to the ED mentions that normally a SME would have about 50 employees, this is not part of the definition and national regulators would decide which entities would be permitted / required to comply with the SMEs IFRS in their jurisdictions. However, an entity with public accountability would *not* be permitted to claim compliance with the SMEs IFRS even if permitted by national law or regulations.

Accounting Policy Hierarchy

The ED proposes a hierarchy for determining an appropriate accounting policy when no specific guidance is available in the SMEs IFRS. A SME first would consider other guidance or requirements contained in the SMEs IFRS; if no other guidance is available, then it would follow the definitions, recognition criteria and measurement concepts contained within Section 2 *Concepts and Pervasive Principles* of the SMEs IFRS. The ED does not propose a mandatory requirement to consider full IFRSs in the absence of

specific guidance, but does propose that full IFRSs dealing with similar issues, as well as pronouncements from other standard setters that use a similar conceptual framework to the IASB, *may* be considered.

Consolidated Financial Statements

The ED proposes that a SME prepare consolidated financial statements unless the entity is itself a subsidiary, *and* the ultimate or an intermediate parent's financial statements comply with full IFRS or the SMEs IFRS. Subsidiaries would be consolidated using the same reporting date as the parent unless impractical; however, there is no guidance on what might be considered an acceptable difference in reporting dates, or the treatment of transactions in the intervening period.

Separate Financial Statements

Similar to full IFRSs, the preparation of separate financial statements would be permitted but not required. The ED proposes that a SME make an accounting policy choice in any separate financial statements to record *all* subsidiaries, associates *and* jointly controlled entities either at cost, as permitted under full IFRSs, or at fair value through profit or loss.

Combined Financial Statements

Combined financial statements present the financial statements of two or more entities controlled by the same investor as if they were a single entity. The SMEs IFRS would permit, but not require, a SME to produce combined financial statements as long as it complied with all other requirements in the SMEs IFRS (e.g., intercompany eliminations). The ED provides no other guidance on how the combination would be performed.

Changes in Equity

Similar to full IFRSs, the ED proposes a choice between presenting a statement of recognised income and expense and a statement of all

changes in equity, but also would permit the presentation of a combined statement of income and retained earnings in certain circumstances.

Investments in Associates

In addition to allowing a SME to account for investments in associates using the equity method, the SMEs IFRS also would allow a SME to record such investments at cost or at fair value through profit or loss. The accounting policy choice would apply to *all* associates.

Interests in Jointly Controlled Entities

In addition to allowing a SME to account for interests in jointly controlled entities using the equity method or proportionate consolidation, the SMEs IFRS also would allow a SME to record such interests at cost or at fair value through profit or loss. The accounting policy choice would apply to *all* jointly controlled entities.

Financial Assets and Financial Liabilities

The ED proposes an accounting policy choice for financial assets and financial liabilities; a SME could apply either the specific provisions in the SMEs IFRS or IAS 39 *Financial Instruments: Recognition and Measurement* in full. If a SME elected to apply the provisions in the SMEs IFRS, then all financial assets and financial liabilities would be measured at fair value through profit or loss, except for the following that would be measured at cost or amortised cost less impairment:

- financial instruments designated as such upon initial recognition (see below)
- certain commitments to make or receive loans that cannot be cash settled
- equity instruments that are not publicly traded and whose fair value cannot be determined reliably, and contracts linked to and to be settled in such instruments.

The ED proposes that a SME could designate an instrument for measurement at amortised cost if *all* of the following conditions are met:

- The instrument has a specified maturity date, or is due on demand.
- The returns to holders are: a fixed amount; a fixed rate of return over the instrument's life; a variable return based on a single referenced quote or observable interest rate (e.g., LIBOR); or a combination of these.
- There are no contractual provisions that could result in the holder losing the principal or interest.
- Contractual provisions permitting the issuer to prepay the instrument or permitting the holder to put it back to the holder are not contingent on future events.
- There are no other conditional returns or repayment provisions.

Hedge Accounting

The ED proposes that hedge accounting be permitted only for the following risks:

- Interest rate risk: for a debt instrument measured at amortised cost; and for a firm commitment or a highly probable transaction.
- Currency risk: for a firm commitment or a highly probable transaction; and for a net investment in a foreign operation.
- Price risk: for commodities held, or for firm commitments or highly probable transactions to buy or sell commodities.

Only interest rate swaps, foreign currency swaps, foreign currency forward exchange contracts and commodity forward exchange contracts would be allowed to be designated as hedging instruments.

Similar to full IFRSs, a SME would need to designate and document its hedging relationships, but effectiveness testing would be limited to demonstrating that

the hedging instrument is expected to be highly effective in offsetting hedged risk. However, the following additional restrictions would apply to the hedging instrument:

- it involves only parties external to the reporting entity
- its notional amount is equal to the designated amount of the hedged item
- its specified maturity date is no later than: the maturity date of the hedged item; the expected settlement date of the commodity purchase commitment; or the occurrence of the highly probable forecast or commodity transaction hedged
- it has no prepayment, early termination or extension features.

Intangible Assets Other than Goodwill

In addition to allowing a SME to account for internally generated intangible assets in accordance with IAS 38 *Intangible Assets* (i.e., by capitalising only qualifying development expenditure), the SMEs IFRS also would allow a SME to expense all expenditure as incurred. The accounting policy choice would apply to *all* internally generated intangible assets.

Equity

The ED proposes that shares issued before the consideration is received be recorded as an increase to equity with an offsetting receivable. If the consideration is received before shares are issued, then equity would be increased only if there is no obligation to repay the amount received. If shares are subscribed for but no consideration has been received, then there would be no increase in equity. Currently there is no guidance in respect of these issues in full IFRSs.

Government Grants

The ED proposes an accounting policy choice for government grants, in terms of which they could be

accounted for either by using the guidance in the SMEs IFRS for *all* government grants, or by using the guidance in the SMEs IFRS for government grants related to assets measured at fair value through profit or loss and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* for other grants.

The ED proposes that government grants be recognised in profit or loss at the fair value of the assets received when all performance conditions attached to the grant have been met. If a grant is received before the conditions have been met, then it would be recognised as a liability.

Borrowing Costs

The ED proposes the same accounting policy choice in respect of borrowing costs as for full IFRSs, i.e., expense all borrowing costs as incurred, or capitalise qualifying borrowing costs. The impact of the forthcoming amendments to IAS 23 *Borrowing Costs* is not known (see *IFRS Briefing Sheet*, Issue 50).

Impairment of Goodwill

The ED proposes an impairment test for goodwill only if an indicator of impairment exists; similar to full IFRSs, an impairment loss could not be reversed.

The following procedures would be followed in identifying and measuring a goodwill impairment loss:

- Allocate goodwill to the lowest level of the business (component) at which it is monitored.
- Measure the fair value of the component, including goodwill.
- Compare the fair value of the component to its carrying amount:
 - If fair value is equal to or greater than the carrying amount, then no impairment loss would be recognised.

- If fair value is less than the carrying amount, then this difference would represent an impairment loss.

If the impairment loss is greater than the carrying amount of the goodwill, then the excess would be allocated to the identifiable non-cash assets of the component based on their relative fair values.

Impairment of Other Non-financial Assets

The ED proposes that indicators of impairment be assessed at each reporting date for *all* assets other than goodwill, and that an impairment test be performed if an indicator of impairment exists (i.e., there would be no instances in which mandatory impairment testing would be required). The impairment loss would be calculated by reference to fair value less costs to sell, determined in respect of the smallest group of assets for which it can be estimated. Similar to full IFRSs, impairment losses could be reversed if an indicator of recovery exists and is supported by a revised impairment calculation. The ED makes no reference to the concepts of value in use or cash-generating units.

Discontinued Operations and Assets Held for Sale

Similar to full IFRSs, the ED proposes separate disclosure of income, expenses and cash flows for discontinued operations but, unlike full IFRSs, the SMEs IFRS would not require the restatement of prior periods if impracticable.

While the ED proposes similar accounting, although with fewer disclosures, to full IFRSs for non-current assets held for sale, there would be no explicit scope exceptions and little supporting guidance.

Employee Benefits

The ED proposes that any gain or loss resulting from the introduction,

change, curtailment or settlement of a defined benefit plan, and all actuarial gains and losses, be reflected in profit or loss when they occur, unless capitalisation is permitted under another section of the SMEs IFRS (e.g., as part of the cost of inventory). The SMEs IFRS would not include an asset ceiling test.

Income Taxes

The ED proposes not to carry over the IAS 12 *Income Taxes* exemption from recognising a temporary difference to the extent that a deferred tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination, and at the time of the transaction does not affect either accounting or taxable income.

Segment Reporting

The SMEs IFRS would not require the presentation of segment information. However, if a SME chose to disclose segment information, then it would need to comply with IFRS 8 *Operating Segments*.

Related Party Disclosures

The ED proposes disclosure requirements for related party transactions similar to those in full IFRSs, but does not include a definition of related parties.

Earnings per Share

The SMEs IFRS would not require the disclosure of earnings per share (EPS). However, if a SME chose to disclose EPS, then it would need to comply with IAS 33 *Earnings per Share*.

Interim Financial Reporting

The ED proposes that if interim financial statements are prepared on a one-time basis, then the prior year annual financial statements could be used as comparatives. Otherwise a SME would need to comply fully with IAS 34 *Interim Financial Reporting*.

Specialised Industries

The ED proposes that biological assets need not be measured at fair value if that fair value cannot be determined without “undue cost or effort”.

The ED does not contain guidance for insurers on the basis that insurance companies could not be SMEs because they hold assets in a fiduciary capacity and have public accountability (see above *Scope and Definition*).

The ED proposes that exploration expenditure related to the exploration for, evaluation or extraction of mineral resources be expensed as incurred.

Transition to the SMEs IFRS

The ED proposes that the accounting treatment adopted under a SME’s previous financial reporting framework (GAAP) *not* be changed in respect of the following (“compulsory exemptions”):

- the derecognition of financial assets and financial liabilities
- hedge accounting
- estimates
- discontinued operations and assets held for sale.

The ED proposes the following voluntary exemptions from the requirements of the SMEs IFRS:

- business combinations prior to the date of transition would not need to be restated – the exemption would be similar to IFRS 1 *First-time Adoption of International Financial Reporting Standards*
- the carrying amount of property, plant and equipment could be based on a previous GAAP revaluation (“deemed cost”)
- cumulative translation differences at the date of transition would not need to be recognised as a separate component of equity – the exemption would be similar to IFRS 1

- compound financial instruments would not need to be split into an equity and a liability component if the liability is not outstanding at the date of transition – the exemption would be similar to IFRS 1
- equity instruments granted before the date of transition would not need to be accounted for in accordance with the SMEs IFRS
- deferred tax would not need to be recognised if recognition would involve “undue cost or effort”

Topics with no Significant Differences from Full IFRSs

The recognition and measurement guidance proposed by the ED in respect of the following topics is similar

to full IFRSs, and as a result is not dealt with in this *IFRS Briefing Sheet*:

- inventories
- investment property
- property, plant and equipment
- business combinations
- leases
- provisions and contingencies
- revenue
- hyperinflation accounting
- foreign currency translation
- share-based payments
- subsequent events.

In respect of the above topics, differences from full IFRSs may nonetheless result from the lack of supporting guidance in the SMEs IFRS.

Effective Date

The ED does not propose an effective date; instead, the SMEs IFRS would take effect from a date determined by the national regulator in each jurisdiction.

Response to the IASB

The IASB has invited comments on the ED by 1 October 2007.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

KPMG International Financial Reporting Group is part of KPMG IFRG Limited.

KPMG International is a Swiss cooperative. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2007 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Publication name: *IFRS Briefing Sheet*

Publication number: Issue 62

Publication date: February 2007