

## IFRS FOR SMEs

## TECHNICAL HIGHLIGHTS 30 November 2009

### *Outline*

*The IASB recently released the International Financial Reporting Standard (IFRS) for Small Medium Enterprises (SME) which can be adopted by SMEs, who fit the bill, with effect from 9 July 2009. A summary of the Standard, including the main differences between the Standard and the full IFRS, is set out below.*

*Meanwhile, Singapore has not yet adopted a similar Standard. However, a taskforce has been formed in 2008 to look into the adoption of the Standard in Singapore's context. An update of the status is set out below.*

### **International Stage**

In July 2009, the International Accounting Standards Board (IASB) released the International Financial Reporting Standard (IFRS) for Small Medium Enterprises (SMEs) (the "Standard"), which is built on the foundation of the full IFRS but a stand-alone product that is separate from former, after a five-year development process. The IFRS for SMEs is designed to meet the needs and capabilities of SME, which are estimated to account for over 95% of all companies around the world.

The Standard defines SMEs as entities that do not have public accountability and publish general purpose financial statements for external users. It is not mandatory for these SMEs to adopt the Standard. The choice is rightly given in view that certain SMEs aspire to get publicly listed and it could be more costly for these SMEs to migrate from IFRS for SMEs to the full set of IFRS as compared to them adopting IFRS from the beginning.

The IFRS for SMEs boosts a more than 85% reduction in the volume of accounting guidance as compared with the full set of IFRS as a result of the following:

#### ▪ **Omission of Topics**

Topics that are deemed to be not relevant to SMEs are omitted and they include IAS 26 *Accounting and Reporting by Retirement Benefit Plans*, IAS 33 *Earnings Per Share*, IAS 34 *Interim Financial Reporting*, IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* and IFRS 8 *Segment Reporting*.

#### ▪ **Removal of Options**

Options given in the full IFRS are removed with the retention of the easier accounting treatment. For example, the revaluation model option is removed for the purpose of accounting of property, plant and equipment under Section 17 (i.e. IAS 16 under full IFRS) Property, Plant and Equipment and intangible assets under Section 18 (i.e. IAS 38 under full IFRS) with the retention of the cost model.

#### ▪ **Simplification of Recognition and Measurement**

Many recognition and measurement principles are simplified. For example, all borrowing costs and research and development costs are to be expensed off when incurred and all intangibles are presumed to have a definite useful life.

- **Reduction of Disclosures**

Disclosures are significantly reduced. One significant reduction is the disclosures with relation to risks of financial instruments.

- **Plain English**

The Standard has been redrafted using plain English for easy comprehension.

Please refer to Appendix A which tables the main differences between the Standards and the full IFRS.

The transition provisions for first-time adoption of IFRS for SMEs are laid out in Section 35 *Transition to the IFRS for SMEs* which allow first time adopters to apply special exemptions, simplifications and other requirements.

Revisions to IFRS for SMEs are tentatively limited to once every three years.

### **Local Stage**

In 2008, the Accounting Standards Council (ASC) formed a dedicated taskforce to consider the issue of differential reporting for SMEs and how it could be applied in Singapore, if considered appropriate.

Currently, all Singapore-incorporated companies are currently required to prepare accounts in accordance with Singapore Financial Reporting Standards (FRS). The ASC is, however, aware that the users of financial statements of SMEs may have different informational needs.

Users of these financial statements are usually owner-managers who are probably not interested in using the financial statements as a means of monitoring the performance of their investments when they have access to all relevant information. Hence, SMEs probably find the complexity of the full set of IFRS being too onerous for them and the costs are most likely to outweigh the benefits arising from the use of the IFRS. The ASC also considers the need for expanded related party disclosure requirements in view that SMEs typically obtain capital from shareholders and directors and it is not uncommon for directors to pledge their personal assets such that the SME can obtain bank financing.

As FRS will eventually converge with IFRS, it is expected that the FRS for SMEs will not deviate much, if any, from the Standard. However, it remains a mystery as to how the ASC will define SME in the local context. Contrary to the definition in the Standard, the ASC taskforce has proposed the use of quantitative criteria in addition to the qualitative criteria.

After considering the definitions that are being currently adopted by other agencies in Singapore such as the Ministry of Trade and Industry (MTI) and the Association of Small and Medium Sized Enterprises (ASME), the taskforce has proposed that an entity would qualify as an SME if and only if the entity is not publicly accountable and if it satisfies two of the following three criteria:

- Net assets do not exceed S\$ 15 million;
- Annual turnover does not exceed S\$ 15 million; and
- Average number of employees does not exceed 200.

The above quantitative criteria might be subject to further changes because they are yet to be finalised as of the date of this publication.

It is worth noting that quantitative criteria have their limitations as an entity may fall within the scope of being an SME one year, out of cope the next year and back within the scope the following year. Hence, the taskforce will definitely need to come up with a more sophisticated system to address such an issue.

#### Other Considerations

There are other considerations, other than whether it would be getting publicly listed, that an entity which qualifies as a SME might take into account when contemplating about whether it should take up the option of complying with the Standard over the full IFRS.

If the entity is a subsidiary of the parent who uses the full IFRS or it is part of a Group that uses the full IFRS, the entity is not prohibited from using the Standard for its own financial statements as long as it qualifies as a SME under the Standard. However, the subsidiary would need to keep two sets of records because the consolidating entity would require the application of the full IFRS for consolidation purposes. Hence, it might be more cost effective for the subsidiary to continue to prepare their financial statements in accordance with the full IFRS.

It is also worth taking the time to look at the Standard to consider the impact of the adoption of the Standard on the financial statements of the entity who qualifies as a SME before rushing to adopt the Standard. For example, an entity who is heavily involved in research and development activities might think twice about adopting the Standard as it probably needs to expense off all costs with relation to their research and development activities under the Standard. Another example is of an entity which, in their course of business, needs to incur substantial borrowing costs for the purpose of constructing or acquiring qualifying assets would need to expense off the costs under the Standard.

DISCLAIMER: The information in this document is for general guidance only and is not a substitute for professional advice. BDO Raffles and its staff accept no responsibility for any actions taken or not taken on the basis of the information in this newsletter. Copyright © November 2009 BDO Raffles. All rights reserved.

#### BDO's Support and Assistance

**If you require any assistance on FRS, please talk to your usual BDO contact.**



#### Appendix A - Main Differences between IFRS for SMEs and full IFRS

Full IFRS	IFRS for SMEs	Main Differences
<b>IAS 1 <i>Presentation of Financial Statements</i></b>	Section 3 <i>Financial Statement Presentation</i>	<ul style="list-style-type: none"> <li>- Removal of requirement to present the financial position of the earliest of the comparative periods in certain circumstances.</li> <li>- Election to present a single statement of income and retained earnings if there are minimum changes to equity during the financial period.</li> </ul>
	Section 5 <i>Statement of Comprehensive Income and Income Statement</i>	- A change from the single statement approach (single statement of comprehensive income) to the two-statement approach (an income statement and a statement of comprehensive income), or vice versa, is a change in accounting policy to which Section 10 <i>Accounting Policies, Estimates and Errors</i> applies.
	Section 6 <i>Statement of Financial Position</i>	<p>- An entity shall present, in the statement of income and retained earnings, the following items in addition to the information required by Section 5 <i>Statement of Comprehensive Income and Income Statement</i>:</p> <ul style="list-style-type: none"> <li>- Retained earnings at the beginning of the reporting period</li> <li>- Dividends declared and paid or payable during the period</li> <li>- Restatements of retained earnings for corrections of prior period errors</li> <li>- Restatements of retained earnings for changes in accounting policy</li> <li>- Retained earnings at the end of the reporting period</li> </ul>
<b>IAS 2 <i>Inventories</i></b>	Section 13 <i>Inventories</i>	- An entity shall measure inventories at the lower of cost and estimated selling price less costs to complete and sell.
<b>IAS 7 <i>Statement of Cash Flows</i></b>	Section 7 <i>Statement of Cash Flows</i>	No significant differences.

Full IFRS	IFRS for SMEs	Main Differences
<b>IAS 8 Accounting Policies, Estimates and Errors</b>	Section 10 <i>Accounting Policies, Estimates and Errors</i>	<ul style="list-style-type: none"> <li>- The entity needs not follow the Standard if:</li> <li>- the Standard does not specifically address a transaction, other event or condition in which case, the entity's management shall use its judgement in developing and applying an accounting policy that results in relevant and reliable information; or</li> <li>- the effect of following the requirement in the Standard is immaterial.</li> </ul>
<b>IAS 10 Events After the Balance Sheet Date</b>	Section 32 - <i>Events After the End of the Reporting Period</i>	No significant differences.
<b>IAS 11 Construction Contracts</b>	Section 23 <i>Revenue</i>	Incorporation into Section 23 <i>Revenue</i> .
<b>IAS 12 Income Taxes</b>	Section 29 <i>Income Tax</i>	<ul style="list-style-type: none"> <li>- Recognition of a valuation allowance against deferred tax assets so that the net amount equals the highest amount that is more than likely that not to be realised on the basis of current or future taxable profit.</li> <li>- The tax basis of an asset equals the amount that would have been deductible in arriving at taxable profit if the carrying amount of the asset had been recovered through sale at the end of the reporting period.</li> <li>- Measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover or settle the carrying amount of the related assets and liabilities.</li> <li>- Probability-weighted average method to be used for the measurement of current and deferred tax assets and liabilities with regards to uncertain tax positions.</li> </ul>

Full IFRS	IFRS for SMEs	Main Differences
<b>IAS 16 Property, Plant and Equipment</b>	Section 17 <i>Property, Plant and Equipment</i>	<ul style="list-style-type: none"> <li>- Applies to property, plant and equipment and investment property whose fair value cannot be measured reliably without undue cost or effort</li> <li>- Revaluation model is disallowed.</li> <li>- Review the previous estimates in arriving at the useful life, residual value or depreciation rate <b>only</b> in the presence of factors, such as the consumption pattern of the asset and changes in the market prices, which indicate significant changes in these estimates.</li> <li>- If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. Other assets shall be depreciated over their useful lives as a single asset.</li> </ul>
<b>IAS 17 Leases</b>	Section 20 <i>Leases</i>	No significant differences.
<b>IAS 18 Revenue</b>	Section 23 <i>Revenue</i>	- Applicable to construction contracts in which the entity is the contractor.
<b>IAS 19 Employee Benefits</b>	Section 28 <i>Employee Benefits</i>	No significant differences.
<b>IAS 20 Accounting for Government Grants and Disclosure of Government Assistance</b>	Section 24 <i>Government Grants</i>	<ul style="list-style-type: none"> <li>- Shall recognise government grants as follows: <ul style="list-style-type: none"> <li>- A grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable.</li> <li>- A grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met.</li> <li>- Grants received before the revenue recognition criteria are satisfied are recognised as a liability.</li> </ul> </li> </ul>
<b>IAS 21 The Effects of Changes in Foreign Exchange Rates</b>	Section 30 <i>Foreign Currency Translations</i>	- Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be initially recognised in the financial statements that include the foreign operation and reporting entity in other comprehensive income and reported as a component of equity. Such exchange differences shall not again be recognised in profit or loss on disposal of the net investment.
<b>IAS 23 Borrowing Costs</b>	Section 25 <i>Borrowing Costs</i>	- Shall recognise all borrowing costs as an expense in profit or loss in the period in which they are incurred.

Full IFRS	IFRS for SMEs	Main Differences
<b>IAS 24 Related Party Disclosures</b>	<b>Section 33 Related Party Disclosures</b>	<ul style="list-style-type: none"> <li>- Exempt from the disclosure requirements in relation to a state that has control, joint control or significant influence over the reporting entity; and another entity that is a related party because the same state has control, joint control or significant influence over both the reporting entity and the other entity.</li> <li>- Must still disclose a parent-subsidiary relationship irrespective of whether there have been related party transactions.</li> <li>- Disclose key management personnel compensation in total.</li> </ul>
<b>IAS 27 Consolidated and Separate Financial Statements</b>	<b>Section 9 Consolidated and Separate Financial Statements</b>	<ul style="list-style-type: none"> <li>- A parent need not present consolidated financial statements if both the following conditions are met: <ul style="list-style-type: none"> <li>(i) The parent is itself a subsidiary*;</li> <li>(ii) Its parent produces consolidated general purpose financial statements that comply with full IFRS or with the Standard**.</li> </ul> </li> <li>- Removal of the requirement for the financial reporting dates for both parent and subsidiary to be within 3 months of each other in the case where it is impracticable for both parent and subsidiary to align their reporting dates.</li> </ul> <p>*Removal of requirement for the entity to obtain the approval of the non-controlling interest to qualify for the exemption.  ** It remains to be seen whether FRS will require the parent's financial statements to also comply with the full IFRS or IFRS for SMEs in view that under the current FRS 27, Singapore FRS does not impose such a requirement as opposed to IAS 27.</p>
<b>IAS 28 Investments in Associates</b>	<b>Section 14 Investments in Associates</b>	<p>There are 3 accounting policies for the measurement of investment in associates as follows:</p> <ul style="list-style-type: none"> <li>- Cost Model: <ul style="list-style-type: none"> <li>- Investments with a published price quotation are to be accounted for using the fair value model.</li> <li>- All other investments are to be accounted for using the cost model.</li> </ul> </li> <li>- Fair Value Model: <ul style="list-style-type: none"> <li>- Investments where it is impracticable to measure fair value reliably without undue cost or effort will be accounted for using the cost model.</li> </ul> </li> <li>- Equity Method</li> </ul>

Full IFRS	IFRS for SMEs	Main Differences
<b>IAS 31 <i>Investments in Joint Ventures</i></b>	Section 15 <i>Investments in Joint Ventures</i>	<ul style="list-style-type: none"> <li>- There are 3 accounting policies for the measurement of investment in joint ventures as follows: <ul style="list-style-type: none"> <li>- Cost Model: <ul style="list-style-type: none"> <li>- Investments with a published price quotation are to be accounted for using the fair value model.</li> <li>- All other investments are to be accounted for using the cost model.</li> </ul> </li> <li>- Fair Value Model: <ul style="list-style-type: none"> <li>- Investments where it is impracticable to measure fair value reliably without undue cost or effort will be accounted for using the cost model.</li> </ul> </li> <li>- Equity Method</li> </ul> </li> <li>- Removal of proportionate consolidation method.</li> </ul>
<b>IAS 32 <i>Financial Instruments: Presentation</i></b>	Section 11 <i>Basic Financial Instruments</i> Section 12 <i>Other Financial Instruments Issues</i> Section 22 <i>Liabilities and Equity</i>	<ul style="list-style-type: none"> <li>- An option to choose as an accounting policy to apply: <ul style="list-style-type: none"> <li>- Provisions of both Section 11 and Section 12; or</li> <li>- Recognition and measurement provisions of FRS 39 <i>Financial Instruments: Recognition and Measurement</i> and the disclosure requirements of Sections 11 and 12.</li> </ul> </li> <li>- Within the scope of Section 11 as a basic financial instrument: <ul style="list-style-type: none"> <li>- Cash</li> <li>- Debt instrument that meets the conditions laid out in Section 11.9</li> <li>- Commitment to receive a loan that cannot be settled net in cash and when executed, it is expected to meet the conditions of being a debt instrument as laid out in Section 11.9</li> <li>- Investment in non-convertible preference shares and non-puttable ordinary shares or preference shares</li> </ul> </li> <li>- Other financial instruments that do not fall within Section 11 will be accounted for under Section 12</li> </ul>
<b>IAS 33 <i>Earnings Per Share</i></b>		Removed.

Full IFRS	IFRS for SMEs	Main Differences
IAS 36 Impairment of Assets	Section 27 <i>Impairment of Assets</i>	<ul style="list-style-type: none"> <li>- Inclusion of inventory</li> <li>- No compulsory annual impairment calculations for goodwill or intangible assets</li> <li>- If goodwill cannot be allocated to individual or groups of cash-generating units on a non-arbitrary basis, the entity shall test the impairment of goodwill by determining the recoverable amount of either: <ul style="list-style-type: none"> <li>(a) The acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated; or</li> <li>(b) The entire group of entities excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.</li> </ul> </li> </ul>
IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	Section 21 <i>Provisions and Contingencies</i>	No significant changes.
IAS 38 <i>Intangible Assets</i>	Section 18 <i>Intangible Assets Other Than Goodwill</i> Section 19 <i>Business Combinations and Goodwill</i>	<ul style="list-style-type: none"> <li>- All expenditure incurred internally on an intangible item, including all expenditure for both research and development activities, shall be expensed off unless it forms part of the cost of another asset that meets the recognition criteria in the Standard.</li> <li>- Forbiddance of revaluation model.</li> <li>- All intangible assets shall be considered to have a finite useful life.</li> <li>- In the event that the entity is unable to reliably estimate the useful of an intangible asset, the life is presumed to be 10 years.</li> <li>- Review of useful life, residual value and depreciation rate only if there is a significant change in the asset or how it is used.</li> </ul>
IAS 39 <i>Financial Instruments: Recognition and Measurement</i>	Section 11 <i>Basic Financial Instruments</i> Section 12 <i>Other Financial Instruments Issues</i> Section 22 <i>Liabilities and Equity</i>	<p><b>Basic Financial Instruments (Section 11)</b></p> <ul style="list-style-type: none"> <li>- Subsequently measured using amortised cost model except for investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares where they will be measured at fair value through profit or loss if they are publicly traded or their fair values can be measured reliably or otherwise, at cost less impairment.</li> <li>- All investments in equity instruments, that are not measured at fair value through profit or loss, shall be assessed individually for impairment regardless of significance.</li> <li>- Simplified derecognition requirements.</li> </ul>

Full IFRS	IFRS for SMEs	Main Differences
		<p><b><u>Other Financial Instruments (Section 12)</u></b></p> <ul style="list-style-type: none"> <li>- Subsequently measured using fair value through profit or loss model except for equity instruments which will be measured at cost less impairment if they are not publicly traded and whose fair value cannot be measured reliably as well as contracts linked to such instruments that, if exercised, will result in delivery of such instruments.</li> <li>- Simplified hedge accounting.</li> </ul>
<b>FRS 40 Investment Property</b>	Section 16 <i>Investment Property</i>	- Adoption of fair value model for the purpose of subsequent measurement unless the fair value cannot be reliably measured without undue cost or effort and in which case the property will be measured using the cost depreciation-impairment model in Section 17.
<b>FRS 41 Agriculture</b>	Section 34 <i>Specialised Activities</i>	<ul style="list-style-type: none"> <li>- An entity using this FRS that is engaged in agricultural activity shall determine its accounting policy for each class of its biological assets as follows: <ul style="list-style-type: none"> <li>- The entity shall use the fair value model for those biological assets for which fair value is readily determinable without undue cost of effort.</li> <li>- Otherwise, the entity shall use the cost model.</li> </ul> </li> </ul>
<b>FRS 102 Share-Based Payment</b>	Section 26 <i>Share-Based Payment</i>	<p>An entity uses a 3-tier measurement hierarchy in the fair valuation of grants:</p> <ul style="list-style-type: none"> <li>- Use observable market price, if available; failing which,</li> <li>- Use entity specific observable market data (e.g. recent transaction in the share options); failing which,</li> <li>- Uses director's best estimate of fair value.</li> </ul>
<b>FRS 103 Business Combination</b>	Section 19 <i>Business Combination and Goodwill</i>	<ul style="list-style-type: none"> <li>- Capitalisation of costs directly attributable to the business combination as part of cost of combination.</li> <li>- Inclusion of contingent consideration in the cost of business combination if payment is probable and can be measured reliably.</li> <li>- Subsequent adjustment is adjusted to cost of investment (company) and goodwill (group).</li> <li>- Require that fair values of assets and liabilities, including contingent liability, should be measured reliably before taking them up as the cost of business combination at the acquisition date.</li> <li>- Goodwill is assumed to have a definite useful life. If the entity is unable to make a reliable estimate, the life is presumed to be 10 years.</li> <li>- Goodwill is measured at cost less accumulated amortisation and accumulated impairment losses.</li> </ul>

Full IFRS	IFRS for SMEs	Main Differences
<b>FRS 105</b> <i>Non-Current Assets Held for Sale and Discontinued Operations</i>	Section 4 <i>Statement of Financial Position</i>	<ul style="list-style-type: none"> <li>- No “held-for-sale” classification or special accounting requirements.</li> <li>- Holding assets for sale triggers an assessment for impairment.</li> <li>- Disclosure of the description of the asset or disposal group held for sale at reporting date, facts and circumstances of the sale or plan, carrying amount of the assets or those assets and liabilities in the disposal group.</li> </ul>
<b>FRS 106</b> <i>Exploration for and Evaluation of Mineral Resources</i>	Section 34 <i>Specialised Activities</i>	<ul style="list-style-type: none"> <li>- Follow Section 17 and Section 18 for the purpose of accounting for expenditure on the acquisition or development of tangible or intangible assets for use in extractive activities.</li> <li>- Follow Section 17 and Section 21 for the purpose of accounting for obligations and costs with relation to the dismantlement or removal of item or restoration of the site.</li> </ul>
<b>FRS 107</b> <i>Financial Instruments: Disclosures</i>	Section 11 <i>Basic Financial Instruments</i> Section 12 <i>Other Financial Instruments Issues</i> Section 22 <i>Liabilities and Equity</i>	<ul style="list-style-type: none"> <li>- Simplified disclosures with no requirement for disclosure of sensitivity analyses nor qualitative and quantitative discussions of risks.</li> </ul>
<b>FRS 108</b> <i>Operating Segments</i>		Removed.