# IFRS for SMEs

## A summary

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# FOREWORD

**Small and medium-sized entities (SMEs) dominate the business world. In virtually every jurisdiction, from the largest economies down to the smallest, over 99% of companies have fewer than 50 employees. There are 21 million SMEs in the European Union, and 20 million in the United States alone.**

In most jurisdictions, the law requires all or many of these companies to prepare financial statements and, often, to have them audited. Normally, the financial statements are filed with the government and available to the public, or are posted on a website, or are available on request.

**Who uses them?** Present and potential lenders (banks and others), vendors, customers, credit rating agencies, family shareholders, venture capital companies, and other capital providers.

**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 (IFRSs) directly or to converge their local generally accepted accounting practice (GAAP) to IFRSs. Securities regulators actively encouraged this trend, because IFRSs are designed to meet the needs of companies whose securities trade in public capital markets. This has increased the scope and complexity of issues covered in IFRSs, the amount of implementation guidance, and the volume of disclosures. The 2009 Bound Volume of IFRSs has grown to 2,855 pages.

In many countries, this complexity has been pushed down to SMEs. SMEs have become increasingly vocal about the burden of complex standards on them as financial statement preparers and about the relevancy of the resulting information to those who use small company financial statements.

A reality in some jurisdictions is that the quality of implementation of full IFRSs (or converged local equivalents) is less than stellar. Some jurisdictions have developed their own SME standards, but often these have serious limitations from the user's perspective, are not readily understood by lenders and other capital providers, particularly across borders, have limited support (e.g. textbooks and software), and are sometimes weakly enforced.

If capital providers do not understand or have confidence in the financial information they receive, an SME's access to, and cost of capital will suffer.

The IFRS for SMEs, issued by the IASB in July 2009, responds to these concerns. It is a 230-page self-contained standard tailored for the needs and capabilities of smaller businesses. Many of the principles in full IFRSs for recognising and measuring assets, liabilities, income, and expenses have been simplified; topics not relevant to SMEs have been omitted; and the number of required disclosures has been significantly reduced. To further lessen the reporting burden for SMEs, revisions to the IFRS will be limited to once every three years.

The IFRS for SMEs is separate from full IFRSs and is therefore available for any jurisdiction to adopt, whether or not it has adopted the full IFRSs. It is also the responsibilty of each jurisdiction to determine which entities should use the standard. IFRS for SMEs was effective immediately on issue.

To support the implementation of the IFRS for SMEs, the International Accounting Standards Committee Foundation is developing comprehensive training material that will be available for free.

The South African Institute of Chartered Accountants was the first country in the world to adopt the IFRS for SMEs as its national SME standard. We expect many others to follow South Africa's example. The IASB is extremely grateful to SAICA for taking the lead and for promoting the IFRS for SMEs by publishing this informative booklet.

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**International Accounting Standards Board**
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# TABLE OF

# CONTENTS.



This booklet is a summary of the requirements of IFRS for Small and Medium-sized Entities, and does not contain all the requirements of the standard. The full standard is available from the IASB website **www.iasb.org.**

# Preface

The IFRS for Small and Medium-sized Entities (IFRS for SMEs) is organised by topic, with each topic presented in a separate section. All of the paragraphs in the standard have equal authority. The standard is a stand-alone document with only one optional cross-reference to full IFRS for financial instruments, which relates to financial instruments (see section 11 and 12).

The standard is appropriate for general purpose financial statements. General purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large.

The International Accounting Standards Board (IASB) intends to issue a comprehensively reviewed IFRS for SMEs after this version has been in use for two years, to address any issues that may arise. Thereafter, a compilation of amendments will be issued every three years.

# Objectives

To develop a set of high quality, understandable and enforceable global standards for SMEs.

The IFRS for SMEs will provide a framework that allows financial statements to be prepared for use by lenders, vendors and other creditors, outside investors, credit rating agencies, and other external parties. The goal is to improve the SMEs' access to capital.

The resulting financial statements are likely to be useful for preparing tax returns or determining distributable income only after adjustments to reflect local laws.

# **Section 1:** Small and Medium-sized Entities

- The IFRS for SMEs is applicable to Small and Medium-sized Entities (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; or
    - 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.

# **Section 2:** Concepts and Pervasive Principles

- The objective of a set of accounts prepared under the SME standard is to provide information on the financial position, performance and cash flows of the entity.
- The following qualitative characteristics need to be met: understandability, relevance, materiality, reliability, substance over form, prudence, completeness, comparability, timeliness and a balance between benefit and cost.
- Recognition criteria for assets, liabilities, income, and expenses include the probability of a flow of economic benefits and the reliability of measurement.
- Pervasive principles include basic guidance for initial and subsequent measurements of assets, liabilities, income, and expense.
- Measurement at initial recognition is generally at historic cost, except where the standard requires fair value.

# **Section 3:** Financial Statement Presentation

- To describe a set of financial statements as compliant with IFRS for SMEs, all the requirements of the standard must be complied with.
- Financial statements must at least be presented annually, be consistent with prior years, include comparative prior-year information, and include all material items.
- A complete set of financial statements includes:
    - A statement of financial position;
    - Either:
        - A single statement of comprehensive income; or
        - A separate income statement and separate statement of comprehensive income.
    - A statement of changes in equity;
    - A statement of cash flows; and
    - Notes to the financial statements.
- A combined statement of income and retained earnings can replace the statement of comprehensive income and statement of changes in equity if the only movements in equity for the period relate to profit and loss, dividends, errors and changes in accounting policy.

## **Section 4:** Statement of Financial Position

- A current/non-current distinction is normally required for presentation unless the liquidity basis is more reliable and relevant.
- The standard sets out minimum presentation requirements required in the statement of financial position.

## **Section 5:** Statement of Comprehensive Income and Income Statement

- The standard gives the option of disclosing a single statement of comprehensive income or a separate income statement and a separate statement of comprehensive income.
- Required to disclose items of other comprehensive income separately in the statement of comprehensive income.
- An analysis of expenses should be presented using either nature or function classification.
- The standard sets out minimum presentation requirements.
- Other comprehensive income only includes actuarial gains and losses, hedging gains and losses, and foreign currency translation reserves.

## **Section 6:** Statement of Changes in Equity and Statement of Income and Retained Earnings

- An entity is required to prepare a statement of changes in equity. If the only changes to its equity during the period arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy, it may elect to show a statement of income and retained earnings, i.e. a combined income statement and statement of changes in equity.
- In the statement of changes in equity, total comprehensive income must be split between amounts attributable to owners of the parent and non-controlling interests (previously called minority interests).

## **Section 7:** Statement of cash flows

- Cash flows must be split into operating, investing and financing activities.
- Operating activities may be presented using either the direct or indirect approach.

## **Section 8:** Notes to the Financial Statements

- This information is provided to support the primary financial statements.
- It includes a summary of accounting policies, information about judgements, and information about estimation uncertainty.
- Required to comply with the disclosure requirements in the rest of the standard.
- Comparative information is needed for all amounts presented in the financial statements.

## **Section 9:** Consolidated and Separate Financial Statements

- If control exists, a parent company should present consolidated financial statements – control exists when a parent is able to govern the financial and operating policies of an entity. It also requires the consolidation of special purpose entities.
- An intermediate parent need not prepare consolidated financial statements if it is a subsidiary of a group where the ultimate parent produces consolidated financial statements under full IFRSs or IFRS for SMEs.
- For consolidated accounts, normal consolidation rules apply.
- In a parent's separate financial statements, it may account for subsidiaries, associates and joint ventures that are not held for sale using either cost or fair value through profit and loss.

## **Section 10:** Accounting Policies, Estimates and Errors

- Provides guidance on the selection and application of the accounting policies.
- If the standard does not address a specific transaction, management should take the following into account when determining an appropriate accounting policy:
    - Requirements and guidance in the IFRS for SMEs dealing with similar or related issues.
    - The definitions, recognition criteria and measurement concepts in the IFRS for SMEs.
- Management may consider the requirements of the full set of IFRS standards in determining an appropriate accounting policy. However, management is not required to do so.
- Accounting policies should be consistent with prior years, unless a change in policy will provide a more reliable outcome or is required by the standard. Voluntary changes in accounting policies are applied retrospectively unless impracticable.
- Changes in accounting estimates are accounted for prospectively.
- Prior period errors are corrected retrospectively unless impracticable.

## **Section 11:** Basic Financial Instruments

- A financial instrument is a contract that creates a financial asset for one entity and a financial liability or equity instrument for another.
- These two sections deal with the recognition, derecognition, measurement and disclosure of all financial instruments. Each entity needs to assess whether its financial instruments falls under the scope of basic financial instruments only, or include other financial instruments.
- A policy choice exists in which an entity may either apply the provisions of these sections or apply IAS 39, ***Financial Instruments: Recognition and Measurement***. If IAS 39 is adopted by an SME, it does not have to comply with the disclosure requirements of IFRS 7, ***Financial Instruments: Disclosure***, but the disclosure required by sections 11 and 12 of this standard must be followed.
- Please note that as this is an accounting policy choice, it is subject to the normal guidance in the IFRS for SMEs regarding changes in accounting policies.
- Interests in subsidiaries, associates and joint ventures; employers' rights; insurance contracts; part of an

entity's own equity leases; and most contracts involving non-financial items are all excluded from this section because they are covered in other sections of the standard.

- Financial assets and liabilities are recognised when the parties become bound by the contractual provisions of the instrument.
- Derecognition of an asset occurs when:
  - the contractual rights to the cash flows from the financial asset expire or are settled;
  - the entity transfers to another party all of the significant risks and rewards relating to the financial asset; or
  - the entity, despite having retained some significant risks and rewards relating to the financial asset, has transferred the ability to sell the asset in its entirety to an unrelated third party which is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer.
- A liability is derecognised when the obligation is settled.

## Summary of section 11:

- Basic financial instruments comprise of the less complex financial instruments that entities carry and therefore this section applies to all entities. Examples of basic financial instruments are - long-term loans, cash, demand and fixed term deposits, trade debtors and trade creditors. Other more complex financial instruments and transactions are dealt with in the next section.
- The recognition model for basic financial instruments is the amortised cost model.
- Basic financial assets and financial liabilities are initially measured at the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss) unless the arrangement constitutes, in effect, a financing transaction. A financing transaction may be indicated in relation to the sale of goods or services, for example, if payment is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate. If the arrangement constitutes a financing transaction, the entity shall measure the financial asset or financial liability at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.
- Subsequent measurement is:
  - Debt instruments at amortised cost using the effective interest method.
  - Debt instruments that are classified as current assets or current liabilities shall be measured at the undiscounted amount of the cash or other consideration expected to be paid or received (i.e. net of impairment) unless the arrangement constitutes, in effect, a financing transaction. If the arrangement constitutes a financing transaction, the entity shall measure the debt instrument at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.
  - Investments in non-convertible preference shares and non-puttable ordinary or preference shares:
    - if the shares are publicly traded or their fair value can otherwise be measured reliably, the investment shall be measured at fair value with changes in fair value recognised in profit or loss; and
    - all other such investments shall be measured at cost less impairment.
- At each reporting date, an entity shall assess financial assets for objective evidence of impairment, if they are not recognised at fair value. If an impairment indicator exists, an impairment test must be done. Reversals of impairments are required if they arise as a result of an event after the impairment was recognised.

## **Section 12:** Other Financial Instruments Issues

- This section deals with other financial instrument issues, and applies to all financial instruments that are not basic financial instruments, for example, derivatives, shares and instruments with highly variable or uncertain cash flows.
- The recognition model for other financial instruments is the fair value model, which is normally the transaction price. This is exclusive of transaction costs.
- Subsequent measurement :
    - Other financial instruments are measured at fair value at the end of each reporting period, and changes in fair value are recognised in profit or loss. There is an exception for equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably, and contracts linked to such instruments that, if exercised, will result in delivery of such instruments. These instruments shall be measured at cost less impairment.
    - If a reliable measure of fair value is no longer available for an equity instrument that is not publicly traded, but is measured at fair value through profit or loss, its fair value at the last date the instrument was reliably measurable is treated as the cost of the instrument. Going forward, the entity shall measure the instrument at this cost amount less impairment until a reliable measure of fair value becomes available.
- A hierarchy for the fair value calculation is provided. The most reliable evidence is a quoted price in an active market. When a quoted price is not available the most recent transaction price provides evidence of fair value. If there is no active market or recent market transactions, a valuation technique should be used.
- Hedge accounting (matching the gains and losses on a hedging instrument and hedged item) is only permitted for specific types of risks (e.g. interest rate risk, foreign exchange risk and foreign exchange risk on a foreign operation) and only if certain specified hedging instruments are used. Comprehensive hedge documentation and a simplified measuring of hedge effectiveness is still required.

## **Section 13:** Inventories

- Inventory is an asset for sale in the ordinary course of business, being produced for sale or to be consumed in production.
- Measurement is at the lower of cost and selling price, less costs to complete and sell.
- Cost is determined using specific identification, weighted average, or FIFO (LIFO not permitted).
- Included in the cost of inventory are costs to purchase, costs of conversion, and costs to bring the asset to its present location and condition.
- Where a production process creates joint products and/or by-products, the costs are allocated on a consistent and rational basis.
- Agricultural produce is measured on initial recognition as inventory at fair value less estimated costs to sell.
- Disclosures include the accounting policies, carrying amounts, amounts expensed during the year, impairments or reversals and any amounts pledged as security.

## **Section 14:** Investments in Associates

- Associates are investments where significant influence exists. Significant influence is defined as the power to participate in the financial and operating policy decisions of the associate, but where there is neither control nor joint control over those policies.

- An entity may elect to account for all its associates:
  - o at cost less impairment, provided there is no published price for the investment. (Where there is a published price, the fair value method shall be used);
  - o using the equity method; or
  - o at fair value with changes in fair value being recognised in profit and loss (fair value method).
- Note that the equity method under the SME standard is different to that under IAS 28. For example, the IFRS for SMEs requires an acquirer to fair value the underlying assets and liabilities of an acquired associate, and account for the resulting goodwill separately.

# **Section 15:** Investments in Joint Ventures

- This is the contractually agreed sharing of control over an entity.
- Three types of joint ventures occur – jointly controlled operations, jointly controlled assets and jointly controlled entities.
- For jointly controlled operations, the venturer should recognise assets that it controls and liabilities it incurs as well as its share of income earned and expenses that are incurred.
- For jointly controlled assets, the venturer should recognise its share of the assets and liabilities it incurs as well as income it earns and expenses that are incurred.
- For jointly controlled entities, an entity may elect to account for these investments:
  - o at cost less impairment, provided there is no published price for the investment. (Where there is a published price, the fair value method shall be used);
  - o using the equity method as for associates (see section 14 above); or
  - o at fair value with changes in fair value being recognised in profit and loss (fair value method).

# **Section 16**: Investment Property

- Investment property is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for:
  - o use in the production or supply of goods or services or for administrative purposes; or
  - o sale in the ordinary course of business.
- Property interests that are held under an operating lease may be classified as an investment property provided the property would otherwise have met the definition of an investment property and the entity can measure the fair value of its property interest without undue cost or effort.
- Measurement is initially at cost and includes costs to bring it into use (except as noted above).
- Subsequently, investment properties must be measured at fair value unless a reliable fair value cannot be obtained without undue cost or effort. Note that this differs from full IFRSs which permits an accounting policy choice between fair value and the cost model.
- Fair value movements are recognised in profit or loss.
- If fair value cannot be determined, the investment property will be treated as property, plant and equipment (refer to next page).

## **Section 17:** Property, Plant and Equipment

- At recognition, property, plant and equipment (PPE) is measured at cost, which includes the purchase price and other costs to bring the asset to the location and condition necessary, as well as any future dismantling costs and site restoration costs, less any discounts or rebates. If payment is to occur over a period of time, cost is the present value of all future payments.
- The following costs are excluded and should be expensed when incurred: new facility opening costs, new product or service launches, and administration and overhead expenditure.
- Borrowing costs shall not be capitalised into the carrying amount of PPE.
- Major spare parts and stand-by equipment are included as part of PPE when an entity expects to use them during more than one period.
- If parts are replaced, the cost will be added to the carrying value of the asset if it is expected to provide incremental economic benefit. If not, then the repairs should be expensed.
- Subsequent to acquisition, the entity shall measure PPE at cost less accumulated depreciation and accumulated impairment losses.
- Assets shall be depreciated over the anticipated useful life after taking into consideration the residual value at the end of the asset's life. The method of depreciation shall be the method that best demonstrates the life of the asset. Clearly identified significant components should be depreciated separately.
- Significant unexpected wear and tear, technological advancement, and changes in market prices may indicate that the residual value or useful life of an asset has changed since the most recent annual reporting period. If such indicators are present, an entity shall review its previous estimates and amend the residual values, depreciation methods and useful lives as required. Such changes shall be accounted for as changes in an accounting estimate. Impairment must be assessed at each reporting date and recognised as a current period expense.
- Indicators of impairment must be considered at each reporting date and, if they exist, the recoverable amount should be determined. Any impairment is recognised in profit or loss.
- Plans to dispose of an asset before the previously expected date is an indicator of impairment and an impairment test shall be performed to determine the extent, if any, of impairment.
- Derecognition shall occur on disposal or when no future economic benefits are expected from the assets – this may result in gains or losses to be recognised in profit and loss for that period.
- The measurement basis, depreciation methods, useful lives, gross carrying amounts and accumulated depreciation, reconciliation showing additions, disposals, acquisitions, impairments, depreciation, any foreign exchange differences, and other changes, shall all be disclosed.

## **Section 18:** Intangible Assets other than Goodwill

- An identifiable non-monetary asset, without physical substance is recognised as an asset when it is probable that future economic benefits will result and the cost can be measured reliably.
- Measurement at initial recognition:
  - o Generally measured at cost, which may include its actual cost, costs to bring it to use, less any discounts.
  - o Measured at fair value in the event of an exchange of assets, as part of a business combination, or as a result, in certain instances of a government grant.

- All research and development expenditures shall be recognised as an expense when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in terms of IFRS for SMEs.
- Items that are always recognised as expenses include: internally generated brands/masthead and others, start-up costs, training costs, advertising, and relocating a division or entity.
- After initial recognition an entity shall measure intangible assets at cost less any accumulated amortisation and any accumulated impairment losses.
- All intangibles are considered to have a finite useful life. For intangible assets arising from contractual or other legal rights the useful life shall not exceed the period of the contractual or legal rights, but may be shorter depending on the period over which the entity expects to use the assets. If an entity cannot reliably estimate the expected useful life of an intangible asset, the life shall be presumed to be 10 years.
- Factors such as a change in how an intangible asset is used, technological advancement, and changes in market prices may indicate that the residual value or useful life of an intangible asset has changed since the most recent annual reporting date. If such indicators are present an entity shall review its previous estimates and amend the residual value, amortisation method or useful life where appropriate. The entity shall account for any such changes as changes in accounting estimates.
- The measurement basis, amortisation methods, useful life, gross carrying amounts and accumulated amortisation, reconciliation showing additions, disposals, acquisitions, impairments, amortisation, and other changes shall all be disclosed.

## **Section 19:** Business Combinations and Goodwill

- All business combinations shall be accounted for using the purchase method.
- Contingent consideration payable in a business combination shall be included in the cost of the business combination at acquisition date if it is probable and can be reliably measured. However, if the potential adjustment is not recognised at acquisition date, but subsequently becomes probable and reliably measurable, the additional consideration shall be treated as an adjustment to the cost of the combination (i.e. an adjustment to goodwill).
- The cost of a business combination shall include any costs directly attributable to the business combination.
- The cost of the acquisition needs to be allocated to the fair value of the identifiable assets and liabilities acquired including a provision for contingent liabilities of the acquiree that can be reliably measured at fair value. A difference shall be recognised as goodwill/negative goodwill. Goodwill is only calculated for the parent’s share of the subsidiary.
- Negative goodwill shall be recognised immediately in profit or loss.
- Where the accounting for a business combination is incomplete by the reporting period in which the combination occurs, provisional amounts can be used for the items for which the accounting is incomplete. The entity has 12 months from the acquisition date to finalise the provisional accounting and shall make any adjustments required as if they were made at the acquisition date. After the 12 months, the only changes to be made shall be to correct an error in accordance with section 10.
- After initial recognition, goodwill shall be measured at cost less accumulated amortisation and impairment losses. If an entity cannot determine the period over which the economic benefits are expected, goodwill shall be amortised over a period not exceeding 10 years.
- An entity shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, showing changes arising from business combinations, impairment losses and disposals of previously acquired businesses.

# **Section 20:** Leases

- Leases are either finance or operating leases. Finance leases result in substantially all the risks and rewards incidental to ownership being transferred to the lessee, whilst operating leases do not.
- Indicators of a finance lease include: ownership transferring to the lessee; bargain purchase option; the lease is for the major part of the economic life of the asset; leased assets are of a specialised nature; the present value of the minimum lease payments amounts to substantially all of the fair value of the asset; the lessee bears the lessor losses if cancelled; a secondary rental period at below market rates; and the residual value risk borne by the lessee.

## Lessees – finance leases:

- The rights and obligations are to be recognised as assets and liabilities at fair value or, if lower, the present value of the minimum lease payments. Any direct costs of the lessee are added to the asset amount recognised. Subsequently, payments are to be split between a finance charge and reduction of the liability. The asset should be depreciated either over the useful life or the lease term.

## Lessees – operating leases:

- Payments are to be recognised as an expense on a straight line basis, unless payments are structured to increase in line with expected general inflation or another systematic basis which is a better representative of the time pattern of the user's benefit.

## Lessors – finance leases:

- The rights are to be recognised as assets held, i.e. as a receivable at an amount equal to the net investment in the lease. The net investment in a lease is the lessor's gross investment in the lease (including unguaranteed residual value) discounted at the interest rate implicit in the lease.
- For finance leases other than those involving manufacturer or dealer lessors, initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term.
- If there is an indication that the estimated unguaranteed residual value used in computing the lessor's gross investment in the lease has changed significantly, the income allocation over the lease term is revised, and any reduction in respect of amounts accrued is recognised immediately in profit or loss.

## Lessors (manufacturer or dealer) – finance leases:

- A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:
    - o profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and
    - o finance income over the lease term.
- The sales revenue recognised at the commencement of the lease term by a manufacturer or dealer lessor is the fair value of the asset or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest.
- The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the entity's policy for outright sales.
- If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.

## Lessors – operating leases:

- Lessors retain the assets on their balance sheet and payments are to be recognised as lease income on the straight line basis, unless payments are structured to increase in line with expected general inflation or another systematic basis which is a better representative of the time pattern of the user's benefit.

### Sale and leaseback:

- If a sale and leaseback results in a finance lease, the seller should not recognise any excess as a profit, but recognise the excess over the lease term.
- If a sale and leaseback results in an operating lease, and the transaction was at fair value, the seller shall recognise immediately any profits or losses.

## **Section 21:** Provisions and Contingencies

### Provisions:

- Provisions are recognised when there is a present obligation as a result of a past event; it is probable that the entity will be required to transfer economic benefits; and the amount can be estimated reliably.
- The obligation may arise from a contract or from law or when there is a constructive obligation due to valid expectations having been created from past events. However, these do not include any future actions. Nor can expected future losses be recognised as provisions.
- These are initially recognised at the best possible estimate at the reporting date. This value should take into account, if material, the time value of money. When the provision has a reimbursive condition from a third party, the reimbursement asset is to be recognised separately only when it is virtually certain payment will be received.
- Subsequently, provisions are to be reviewed at each reporting date and adjusted to meet the best current estimate. Any adjustments are recognised in profit and loss, while any unwinding of discounting shall be treated as a finance cost.

### Contingent liabilities:

- These are not recognised as liabilities on the balance sheet.
- Unless remote, disclose an estimate of the financial effect, indications of the uncertainties relating to timing or amount and the possibility of reimbursement.

### Contingent assets:

- These are not recognised as assets on the balance sheet.
- Disclosure requrements of this section requires a description of the nature and the financial effect.

### Prejudicial disclosure:

- In extremely rare cases, where the disclosure of information required for provisions, contingent liabilities or contingent assets can be expected to seriously prejudice the position of the entity in a dispute with other parties, the standard allows an exception. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

## **Section 22:** Liabilities and Equity

- Shares are only recognised as equity when another party is obliged to provide cash or other resources in exchange for the instruments. The instruments are measured at the fair value of cash or resources received, net of direct costs of issuing the equity instruments, unless the time value of money is significant, in which case initial measurement is at the present value of the amount.
- The principles outlined above should also be applied to equity issued by means of options, rights or similar equity instruments.

- Members' shares in co-operative entities and similar instruments are only classified as equity if the entity has an unconditional right to refuse redemption of the members' shares or the redemption is unconditionally prohibited by local law, regulation or the entity's governing charter. If the entity cannot refuse redemption, the members' shares are classified as liabilities.
- A puttable financial instrument is only recognised as equity if it has all of the following features:
    - o The holder is entitled to a pro rata share of the entity's net assets in the event of liquidation;
    - o The instrument is the most subordinate class of instrument;
    - o All financial instruments in the most subordinate class have identical features;
    - o Apart from the puttable features, the instrument includes no other financial instrument features; and
    - o The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the change in the value of the entity.
- Instruments are deemed to be equity if they impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.
- Capitalisation and bonus issues and share splits do not result in changes to total equity. An entity shall reclassify amounts within equity as required.
- When shares are issued before the cash or other resources are received, the amount receivable is presented as an offset to equity in the statement of financial position and not as an asset.
- When cash or other resources are received before shares are issued, and the entity cannot be forced to repay the cash or other resources received, the cash or resources are recognised as an increase in equity.
- Any shares subscribed for which no cash is received cannot be recognised as equity before the shares are issued.
- Compound financial instruments, i.e. those that contain both liability and equity components, should be split by the entity at issuance. The liability is measured at fair value, with the difference being the equity component. The liability is subsequently measured using the effective interest rate method.
- Treasury shares are an entities' own shares that are acquired or reacquired. The fair value of the consideration received shall be deducted from equity. No gain or loss shall be recognised in profit and loss on the subsequent resale of treasury shares.
- Changes in the non-controlling interest that do not affect control, shall not result in a gain or loss being recognised in profit and loss. These are equity transactions between the entity and its owners.
- Dividends paid in the form of distribution of assets, other than cash, are recognised when the entity has an obligation to distribute the non-cash assets. The dividend liability is measured at the fair value of the assets to be distributed.

## **Section 23:** Revenue

- Revenue results from the sale of goods, services being rendered, construction contracts by the contractor and the use by others of your assets, yielding interest, royalties or dividends.
- The following are excluded from this section and dealt with elsewhere: leases (section 20), dividends from equity accounted entities (section 14 and 15) changes in fair value of financial instruments (section 11 and 12), initial recognition and subsequent re-measurement of biological assets (section 34) and initial recognition of agricultural produce (section 34).
- Measurement of revenue shall be the fair value of the consideration received, taking into account any possible trade discounts or rebates, including volume rebates and prompt settlement discounts.

- Deferred payment terms result in a financing transaction where the fair value of the consideration is the present value of all future receipts. The difference is recognised as interest revenue.
- Sale of goods is recognised when: the significant risks and rewards have passed; no managerial involvement remains; the amount of revenue and costs can be measured reliably; it is probable that benefits will flow to the entity; and costs can be measured reliably.
- Rendering of services is recognised based on the stage of completion basis when: the amount can be estimated reliably; there is a probable inflow of benefits; the stage of completion can be measured; and costs incurred and that will be incurred can be reliably estimated. If the outcome is unreliable, then revenue should be recognised to the extent of the expenses incurred.
- Award credits or other customer loyalty plan awards need to be accounted for separately, and therefore reduce the amount of revenue that is recognised upfront. The revenue related to the award credits is deferred and recognised when the awards are redeemed.
- Interest, royalties and dividends are recognised when it is probable that an inflow of economic benefits will occur and it can be reliably measured. Interest is recognised using the effective interest method, royalties on an accrual basis per the agreement and dividends when the right to receive the dividend is established.
- Construction contracts result in revenue when it can be reliably estimated and an inflow of economic benefits is probable. Revenue is then recognised based on the stage of completion. An estimation of the stage of completion requires estimates of future costs, billings and time frames to completion.
- For construction contracts, revenue recognition is usually applied to each contract, but it may be necessary to apply it to each separately identifiable component of a contract, or group of contracts collectively.

## **Section 24:** Government Grants

- Income tax benefits are excluded from the scope.
- Grants are measured at the fair value of the assets received or receivable.
- Grants without future performance conditions should be recognised when proceeds are receivable. However, if there are conditions, they should only be recognised when the conditions are met.

## **Section 25:** Borrowing Costs

- Borrowing costs are interest and other costs arising on an entity's financial liabilities and finance lease obligations.
- All borrowing costs should be expensed, even when the costs relate to an asset that takes a substantial period of time to construct. Therefore, there is no option to capitalise borrowing costs.

## **Section 26:** Share-based Payment

- This section covers all share-based payment transactions, that is, cash or equity settled.
- Equity settled:
    - These transactions shall be recorded at the fair value of the goods and services received, if this can be estimated reliably.
    - For transactions with employees or where the fair value of goods and services received cannot be reliably measured, these should be measured with reference to the fair value of the equity instruments granted.

- Cash settled:
    - A liability is to be measured at fair value on grant date and subsequently at each reporting date as well as settlement date, with each adjustment being recognised in profit and loss for the period.
- Cash alternatives:
    - Account for all such transactions as cash settled, unless the entity has a past practice of settling by issuing equity instruments or the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than, the fair value of the equity instrument.
- Where shares only vest after a specific period of service has been completed, the expense shall be recognised as the service is rendered.
- Certain government-mandated plans provide for equity investors (such as employees) to acquire equity without providing goods or services that can be specifically identified (or by providing goods or services that are clearly less than the fair value of the equity instruments granted). These are equity-settled share-based payment transactions within the scope of this section.

## **Section 27:** Impairment of Assets

- Inventories:
    - At each reporting date, the carrying amount of the inventory should be compared to the selling price less costs to complete and sell. If the item is impaired, the amount shall be recognised immediately in profit and loss for the period.
    - When the circumstances that led to the impairment no longer exist, the impairment may be reversed.
- Other non-financial assets:
    - An entity shall assess, at each reporting date, whether there is an indicator of impairment. If there is, the carrying amount of the assets should be compared to the recoverable amount, and any resulting impairment recognised.
    - The recoverable amount is the higher of the fair value less costs to sell and the value-in-use.
    - If an impairment indicator exists, the entity should review the useful life and the depreciation methods even though an impairment loss may not be recognised.
    - When the circumstances that led to the impairment no longer exist, the impairment may be reversed.
    - If it is not possible to estimate the recoverable amount of an individual asset, the cash-generating unit to which the asset belongs needs to be identified and tested for impairment.
- Goodwill:
    - An entity shall assess at each reporting date whether there is an indicator of impairment of goodwill.
    - If there is an indicator of impairment, the entity should: allocate the goodwill to components of the entity that benefit from the goodwill; measure the fair value of the components; compare the fair value to the carrying amount of the component; recognise any resulting impairment first against the goodwill and then against the non-current assets of the component.
    - No reversal of goodwill impairments is permitted.

# **Section 28:** Employee Benefits

- Short-term benefits:
  - Measured at an undiscounted rate and recognised as services are rendered. Other costs, such as annual leave, are recognised as the related services are rendered if the costs accumulate, otherwise the cost is expensed when the leave is taken or used. Bonus payments are only recognised when an obligation exists and the amount can be reliably estimated.
- Post-employment benefits - Defined contribution plans:
  - Contributions are recognised as a liability and expensed when the contributions are due. Any prepayments of contributions made shall be recognised as assets.
- Post-employment benefits - Defined benefit plans:
  - Recognise a liability based on the net of, present value of defined benefit obligations less the fair value of any plan assets, at the balance sheet date.
  - The projected unit credit method is required, provided it does not involve undue cost or effort. Simplifications are incorporated to overcome the requirement to use the projected unit credit method.
  - An alternative accounting policy option is allowed for actuarial gains and losses. The alternative allows the recognition in other comprehensive income.
- Other long-term benefits:
  - The entity shall recognise a liability at the present value of the benefit obligation, less any fair value of plan assets.
- Termination benefits:
  - These are recognised immediately in profit and loss when certain requirements are met, as there are no future economic benefits to the entity.

# **Section 29:** Income Tax

- Current tax:
  - An entity recognises a current tax liability should the current tax payable exceed the current tax paid at that point in time. A current tax asset is recognised when current tax paid exceeds current tax payable or the entity has carried a loss forward from the prior year and this can be used to recover current tax in the current or future years.
  - Current tax assets and liabilities for current and prior periods shall be measured at the actual amount that is owed or owing using the applicable tax rates enacted or substantively enacted at the reporting date. The measurement shall include the effect of the possible outcomes of a review by the tax authorities.
- Deferred tax:
  - A temporary difference is a difference between the carrying amount of an asset, liability or other items and its tax basis that will result in a taxable or deductible amount in the future. The term "other items" includes items that are not recognised as assets or liabilities in the statement of financial position.
  - The tax basis is the measurement of an asset, liability or equity instrument under applicable substantively enacted tax law at the reporting date. A notion of a tax balance sheet is created.
  - Deferred tax is based on the recovery or settlement of assets and liabilities at their current carrying amounts.

- A deferred tax liability is recognised for income tax payable in the future reporting periods in respect of temporary differences.
- Deferred tax assets shall be recognised in full for income tax recoverable in future periods in respect of temporary differences, unused tax losses and unused tax credits. However a valuation allowance is required where future taxable profit is not probable.
- Two exemptions are available. Deferred tax is not recognised for the initial recognition of goodwill. Deferred tax is also not recognised for temporary differences associated with unremitted earnings from foreign subsidiaries, branches, associates and joint ventures in certain instances.
- Recognition of changes in current or deferred tax must be allocated to the related components of profit or loss, other comprehensive income and equity.
- No discounting of deferred tax balances is allowed.

# **Section 30:** Foreign Currency Translation

- Each entity should identify its functional currency, being the currency of the primary economic environment in which it operates. A change in functional currency is applied prospectively from the date of the change.
- Recording transaction in an entities functional currency:
    - On initial recognition, an entity shall record the transaction by applying the spot rate at the date of the transaction. An average rate may be used, unless there are significant fluctuations in the rate.
    - At reporting date, the entity shall translate foreign currency monetary items using the closing rate. Translation of non-monetary items depends on whether they are recognised at historical cost or fair value. For non-monetary items measured using historical cost, the exchange rate at the date of the transaction shall be used, whilst for non-monetary items measured using fair value, the exchange rate at the date when the fair value was determined shall be used.
- Exchange differences are normally recognised in profit and loss. The only exemptions are for monetary items that form part of the investment in foreign operations and the translation into a different presentation currency.
- Exchange differences arising from a monetary item that forms part of the net investment in a foreign operation, is recognised in profit or loss in the financial statements of the individual entities. However, in the consolidated financial statements such exchange differences are recognised in other comprehensive income.
- Exchange differences on translation to a different presentation currency are recorded in other comprehensive income. This will include the translation of foreign subsidiaries.
- Goodwill arising on the acquisition of a foreign operation is deemed to be an asset of the foreign operation, and translated at the closing rate at year end.
- When a foreign operation is disposed of, any cumulative amount recognised in equity is included in the calculation of the profit and loss on disposal.

# **Section 31:** Hyperinflation

- No absolute rate at which an economy is deemed hyperinflationary is given. Certain indicators are provided, including where a county's cumulative inflation rate approaches or exceeds 100% over a 3 year period, wealth is maintained in non-monetary assets or foreign currencies and where interest rates, wages and prices are linked to a price index.

- All amounts in the financial statements must be stated in terms of the presentation currency at the end of the reporting period. The presentation currency is the hyperinflation currency in which the financial statements are presented. Comparative information and any information presented in respect of earlier periods must also be restated in the presentation currency using the most recent index.
- The restatement of financial statements is performed by using a general price index that reflects changes in general purchasing power. If available, a general price index, which may be produced by the government, is used.
- All assets and liabilities not recorded in the presentation currency at the end of the reporting period must be restated by applying the general price index. Different restatement procedures are provided for monetary and other items. Special restatement procedures apply to equity and retained earnings.
- All amounts in the statement of comprehensive income and statement of cash flows must also be recorded at the presentation currency at the end of the reporting period. These amounts are restated by applying the general price index from the dates when they were recorded.
- The profit or loss on the net monetary position is included in profit or loss. The profit or loss is adjusted by those assets and liabilities linked by agreement to changes in prices.

## **Section 32:** Events after the end of the Reporting Period

- Adjusting events:
    - o An entity should adjust amounts recognised in the financial statements to reflect events that provide evidence of conditions that existed at the reporting date.
- Non-adjusting events:
    - o No adjustment is made for events that are indicative of events that arose after the reporting date. The entity shall disclose the nature of the event and an estimate of its financial effect.
- Dividends:
    - o Dividends approved after the balance sheet date shall not be recognised as a liability at year end.

## **Section 33:** Related Party Disclosures

- Relationships between parent entities and subsidiaries shall always be disclosed, including the ultimate controlling party.
- Disclosure is required of key management personnel's short-term benefits, post-employment benefits, other long-term benefits, termination benefits and share-based payments. Key management personnel are persons responsible for planning, directing and controlling the activities of an entity, and include executive and non-executive directors.
- For transactions between related parties, an entity must disclose:
    - o Nature of the relationship.
    - o Information about the transactions and outstanding balances necessary to understand the potential impact on the financial statements.
    - o Amount of the transaction.
    - o Provisions for uncollectible receivables.
    - o Any expense recognised during the period in respect of an amount owed by a related party.

# **Section 34:** Specialised Industries

- Agriculture:
  - Where the fair value of each biological asset is readily determinable without undue cost or effort, an entity engaged in agricultural activity shall apply the fair value through profit or loss model.
  - Where the fair value is not readily determinable, or is determinable only with undue cost or effort, the entity shall measure its biological assets at cost less accumulated depreciation and impairment.
  - At harvest, agricultural produce shall be measured at fair value less estimated costs to sell.
- Extractive industries:
  - Expenditure on tangible or intangible assets to be used in extractive activities shall be accounted for under section 17 (property, plant and equipment) and section 18 (Intangible assets other than goodwill) of this standard.
  - Requirements to dismantle or remove items, or restore sites, shall be accounted for using section 17 (property, plant and equipment) and section 21 (provisions and contingencies) of this standard.
- Service concession arrangements:
  - Guidance is provided on how the operator accounts for a service concession arrangement. The operator either recognises a financial asset or an intangible asset depending on whether the grantor has provided an unconditional guarantee of payment or not.
  - A financial asset is recognised to the extent that the operator has an unconditional contractual right to receive cash or another financial asset from, or at the direction of, the grantor for the construction services.
  - An intangible asset is recognised to the extent that the operator receives a right or license to charge users for the public service.

# **Section 35:** Transition to the IFRS for SMEs

- This section is to be applied by first time adopters of IFRS for SMEs, regardless of whether their previous reporting was under full IFRS or another GAAP, including the Exposure Draft of IFRS for SMEs which was adopted as a Statement of Generally Accepted Accounting Practice for Small and Medium-sized Entities in South Africa.
- The opening balance sheet for the comparative period shall be adjusted for:
  - Recognition of assets and liabilities required under IFRS for SMEs.
  - Derecognition of assets and liabilities not permitted under IFRS for SMEs.
  - Reclassification of assets, liabilities or equity under the IFRS for SMEs.
  - Any adjustments to the measurement of any assets and liabilities arising from application of the IFRS for SMEs.
- The following transactions shall not be amended on adoption of the IFRS for SMEs:
  - derecognition of financial assets and liabilities;
  - hedge accounting;
  - accounting estimates;
  - discontinued operations; and
  - measuring non-controlling interests.

- An entity's date of transition to IFRS for SMEs is the beginning of the earliest period for which the entity presents full comparative information in accordance with this standard in its first financial statements that conform with IFRS for SMEs.
- Optional exemptions exist on first time adoption for business combinations, share-based payments, fair value or revaluation as deemed cost, separate financial statements, service concession arrangements, extractive industries, arrangements containing a lease, cumulative translation differences, decommissioning liabilities included in PPE, compound financial instruments, share-based payment transactions and deferred income taxes.
- Disclosure of the impact of the transition on the financial position, financial performance and cash flows is required. In addition, reconciliations of equity and profit and loss as previously reported, must be given. Any errors in the application of the previous reporting framework must be separately disclosed.

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