

1 SCOPE OF THE IFRS FOR SMEs

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GENERAL SCOPE

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

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

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

DEFINITIONS

General Purpose Financial Statements

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

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

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

Public Accountability

An entity has public accountability if:

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

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

Traded in a Public Market

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

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

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

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

Fiduciary Capacity

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

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

- Banks
- Credit unions

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

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

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

EXAMPLE 1.1

Purchase of an Asset Management Company

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

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

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

Required

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

Suggested Solution

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

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

APPLICATION TO SUBSIDIARY COMPANIES

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

EXAMPLE 1.2

Acquisition by an International Investment Entity

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

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

Required

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

Suggested Solution

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

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

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

APPLICATION BY MICRO-ENTITIES

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

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

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

SUMMARY

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

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