

IFRS for SMEs

Is this the end for Irish/UK GAAP?

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Current proposals from the UK-based Accounting Standards Board (ASB) would see Irish and UK GAAP as we currently know it cease to exist by 2012 to be replaced by either full IFRS or *IFRS for SMEs*. Irene O’Keeffe and Fiona Hackett consider some key aspects of the proposals and discuss their likely impact on a large number of Irish entities.

Published in August 2009, the ASB’s Consultation Paper on *The Future of UK GAAP* proposes a three-tier financial reporting structure as follows:

Tier 1

All Irish and UK entities that are ‘publicly accountable’ would use full IFRS for their consolidated and individual accounts. Publicly accountable entities typically include listed companies, banks/deposit-takers, insurance entities, many investment funds and credit unions;

Tier 2

All Irish and UK non-publicly accountable companies above the small threshold would use the IFRS for SMEs; and,

Tier 3

As at present, small companies that are not publicly accountable would be entitled to use the ASB’s FRSSE.

Within the three-tier structure entities would have the option to ‘opt-up’ to a higher level. Tier 3 entities could elect to prepare their financial statements using FRSSE, *IFRS for SMEs* or full IFRS. Tier 2 entities could elect to prepare their financial statements using *IFRS for SMEs* or full IFRS. Tier 2 will catch a large number of private entities in Ireland including subsidiaries of listed companies.

The *IFRS for SMEs* is intended to apply to entities that:

- ▶ do not have public accountability; and
- ▶ publish general purpose financial statements for external users.

Many have commented that the ‘SME’ (small and medium-sized entities) title is somewhat misleading given that private companies with multi-billion Euro balance sheets that aren’t publicly accountable would fall into the scope of this standard.

An entity is deemed to have public accountability if:

- ▶ It has debt or equity instruments traded in a public market,
- ▶ It is in the process of issuing debt or equity instruments for trading in a public market, or
- ▶ It is a deposit-taker and holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses, typically banks, credit unions, insurance companies, investment banks and mutual funds.

Additionally the proposals could also mean that a number of private companies that meet the definition of publicly accountable are faced with

transitioning their financial statements to full IFRS.

The proposed structure contains no size limit on the definition of ‘public accountability’, therefore a number of entities such as credit unions and investment funds may have to prepare financial statements in accordance with full IFRS.

Comparing *IFRS for SMEs* to full IFRS

For certain entities, one of the attractions of the *IFRS for SMEs* is the significantly reduced disclosure requirements when compared to full IFRS. It is estimated that there are up to 80% fewer disclosure requirements than under full IFRS. *IFRS for SMEs* runs to about 300 pages, compared to about 3,000 pages in full IFRS.

A number of topics in full IFRS that are not considered relevant to SMEs have been omitted. There is no guidance, for example, on operating segments or on earnings per share. A number of full IFRS accounting policy options have also been removed. Only one policy option is allowed so there is, for example, no option to carry property, plant and equipment at valuation in the *IFRS for SMEs*.



Comparison with Irish GAAP

For many Irish entities the new standard presents challenges. There are a number of potential measurement differences and significantly enhanced disclosure requirements (compared to Irish GAAP). Preparing financial statements in accordance with *IFRS for SMEs* would see a significant number of UK and Irish entities coming to terms with a very different look and feel for their financial statements.

Measurement differences

Income taxes

IFRS for SMEs employs a balance sheet methodology to calculating deferred tax, which is a conceptually different methodology to FRS 19, *Deferred Tax*.

Business combinations

Under *IFRS for SMEs*, the purchase method of accounting is used to account for all business combinations in scope – there is, therefore, no concept of merger accounting, as there is under FRS 6, *Acquisitions and Mergers*.

Intangible assets and goodwill

The definition of an 'intangible asset' under *IFRS for SMEs* should lead to a greater number of intangible assets being recognised in business combinations, when compared to accounting for acquisitions under Irish GAAP. Such intangible assets

would include customer relationships and customer contracts.

Employee benefits

IFRS for SMEs gives entities an accounting policy choice in relation to accounting for actuarial gains and losses in defined benefit pension schemes; such gains and losses can be recognised in profit or loss or in other comprehensive income (equivalent to the STRGL under UK and Irish GAAP).

Financial Instruments

Under *IFRS for SMEs*, where an entity has complex financial instruments (such as derivatives), they would be required to recognise such instruments at fair value with changes generally recognised in profit or loss. This would represent a significant change for entities that currently do not have to apply the provisions of FRS 26, *Financial Instruments: Recognition and Measurement*.

Cash Flow Statements

Under *IFRS for SMEs*, a complete set of financial statements will include a statement of cash flows. A number of UK and Irish entities currently avail of an exemption from preparing a cash flow statement as they are included in the consolidated financial statements of a parent that are publicly available.

Fair value through profit or loss

IFRS for SMEs allows or requires much greater use of 'fair value through profit or loss' than UK and Irish GAAP. Derivative financial instruments, investment property, biological assets and investments in listed shares are generally required to be accounted for at fair value through profit or loss. *IFRS for SMEs* also introduces the option to account for investments in associates or joint ventures at fair value through profit or loss.

Disclosure differences

IFRS for SMEs would introduce a number of detailed disclosure requirements that would be new to entities currently preparing financial statements under Irish GAAP, such as:

Related party disclosures

There are no exemptions from disclosing transactions with other group companies under *IFRS for SMEs*, unlike FRS 8, *Related Party Disclosures*, which provides exemptions in certain situations.

Information about judgements and sources of estimation uncertainty

IFRS for SMEs introduces a requirement to disclose information about significant judgements made by management in applying an entity's accounting policies together with information about the key assumptions concerning the future, and other key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

What next?

With the ASB's consultation paper on the future of UK and Irish GAAP recently issued, it would be prudent for companies to consider how the proposals may impact their financial statements and to perhaps get involved in the ASB's consultation process. The closing date for comments on the ASB's proposal is 1 February 2010.

Companies should start planning and working on the basis that the ASB will require adoption of IFRS in Ireland, either full IFRS or based on the SME standard, by 2012. The year 2012 may seem a long way off but it is important to start thinking about this now. The opening balance sheet for December year-ends will be as at 1 January 2011, which means that related conversion decisions need to be made in 2010.

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