IFRS for SMEs

IFRS for Small and Medium-sized Entities

How does this affect US companies?

The recent release of IFRS for Small and Medium-sized Entities (SMEs) will affect companies with multinational subsidiaries. Do you know what the potential impact will be on your company?

Highlights

What is IFRS for SMEs?

You may need to begin planning soon for the proposed UK statutory adoption

IFRS for SMEs - an option for you and your subsidiaries

Assessing the advantages and disadvantages

What should you do now?

International Financial Reporting Standards ("IFRS") has been affecting US companies for some time - through their business dealings with non-US counterparties (particularly with customers and vendors), convergence between US GAAP and IFRS, or through non-US subsidiaries that have already adopted or are adopting IFRS for local statutory reporting or financing purposes.

For US companies with non-US subsidiaries, the impact of continued global IFRS adoption is likely to increase in the foreseeable future following the IASB's recent issuance of IFRS for SMEs. The release of this standard, designed to ease the burden of IFRS reporting for SMEs, is likely to trigger an increase in the number of countries where IFRS replaces existing national GAAP as the primary basis for local statutory financial reporting. For instance, the United Kingdom Accounting Standards Board (UK ASB) has already issued a consultation paper asking for comments (by February 2010) on proposals that would replace existing UK Generally Accepted Accounting Principles (UK GAAP) with IFRS, or IFRS for SMEs, by 2012.

In this publication we take a closer look at recent developments in the UK, where detailed guidance has been proposed regarding the transition from local GAAP to IFRS for statutory reporting purposes. We will also focus on the impact of IFRS for SMEs on US companies, including the importance of appropriate corporate headquarters involvement in the IFRS transition process of non-US subsidiaries.

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What is IFRS for SMEs?

In July 2009, the IASB released IFRS for SMEs after a five-year development process involving extensive consultation worldwide. IFRS for SMEs is a self-contained standard of about 230 pages, tailored for the needs and capabilities of smaller businesses. A number of the full IFRS principles for recognizing 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. For instance, under IFRS for SMEs, goodwill is amortized and only tested for impairment when there is a triggering event, instead of being subject to a full impairment test each year. In addition, development costs are expensed under IFRS for SMEs while they are capitalized under full IFRS. Other key simplifications can be found in the sections on financial instruments, defined benefit obligations, interest capitalization and cash flow presentation.

IFRS for SMEs is separate from full IFRS and is available for any jurisdiction to adopt whether or not it has adopted full IFRS. SMEs are defined as entities that do not have public accountability and that publish general-purpose financial statements for external users. The IASB has indicated that each jurisdiction will need to determine which entities should use the standard.

Recent developments

Although the UK has been using full IFRS for public entities since 2005, in early August, the UK ASB issued a consultation paper that sets out a roadmap for the replacement of UK GAAP with a new three-tier reporting framework based on IFRS. Though the UK ASB still needs to go through its normal consultation process, they have indicated that adoption of IFRS in the UK is a high priority. Further, the consultation paper recommends mandatory adoption of IFRS in the UK for statutory reporting purposes for fiscal years beginning on, or after, January 1, 2012. For calendar year end companies, this means that the IFRS opening balance sheet will be January 1, 2011. As such, conversion analysis and decisions may need to be made in 2010.

Under the proposed three-tiered reporting framework UK public companies will continue to apply full IFRS, and all other companies except those that qualify as small companies would be required to report under IFRS for SMEs or full IFRS. The table below indicates that US companies with subsidiaries in the UK that do not qualify as small companies will need to prepare their subsidiaries' statutory accounts using either full IFRS or IFRS for SMEs.

Accounting regime *	Type / nature of entities
Tier 1 - Full IFRS	Publicly accountable entities
Tier 2 - IFRS for SMEs	Non-publicly accountable entities
Tier 3 - Financial Reporting Standard for Smaller Entities (FRSSE) **	Small companies

Notes:
* All entities will have the option to voluntarily adopt a higher tier.
** Existing UK GAAP standard available to companies that do not exceed two or more of the following criteria: (i) Turnover / Revenue - £6,500,000; (ii) Total assets- £3,260,000; (iii) Average number of employees - 50.

Adoption considerations

There are a number of advantages and disadvantages in choosing to apply full IFRS compared to IFRS for SMEs. Should IFRS eventually be adopted in the US, as many expect, public companies would be required to adopt full IFRS. By electing full IFRS for non-US subsidiaries, companies will have an opportunity to maximize alignment of local IFRS statutory reporting policies with group policies. As a result, US companies may be able to streamline their consolidation process and increasingly utilize shared service centers. In addition, full IFRS, because of existing financial reporting in the global markets, provides more precedent with respect to accounting and disclosures. Some believe full IFRS would be easier to apply because of this precedent as compared to IFRS for SMEs which may have difficulties in application due to the lack of specificity and precedent in the marketplace. Lastly, if companies possibly intend to seek public financing for their subsidiaries, they may be best positioned to do so by using full IFRS to avoid the need to convert their accounting down the road.

On the other side of the argument, however, full IFRS has more complex measurement and recognition requirements as well as many additional disclosures which would be required to be prepared annually. IFRS for SMEs offers a simpler accounting model to apply, which may reduce the time and cost of annually preparing statutory filings. Because it is less specific in many areas, some believe that IFRS for SMEs also may allow companies to choose still simpler accounting models for their subsidiaries. Furthermore, many believe that as the use of IFRS for SMEs is increasingly allowed for statutory filings around the world, shared service centers would be able to be used to further centralize accounting expertise, create efficiencies and reduce costs.

But these advantages and disadvantages must also be considered within the two broader contexts—systems capabilities and tax and cash flow planning. Continued global adoption will require companies to assess whether their financial reporting systems are capable of multi-GAAP reporting in the transition from local GAAP to full IFRS or IFRS for SMEs and for ongoing reporting purposes. For example, are accounting systems capable of capturing both IFRS and IFRS for SMEs so that both statutory reporting and consolidated accounts easily can be prepared through captured information by one system? If IFRS for SMEs is selected, are accounting systems capable of generating the information needed should the additional disclosure requirements of full IFRS become necessary in the future at the corporate level? Also, conversion of non-US subsidiaries may have cash tax and effective tax rate impacts. There could be implications as well to a company's treasury plan. For example, planned repatriations may be impacted by changes and/or limitations in distributable reserves.

Clearly, it will be important for appropriate representatives of the corporate head office to lead the determination of which version of IFRS to adopt, to ensure that decisions taken at a local level are in the best interests of the group as a whole and that the efficiencies of one common set of accounting policies are maximized.

What does this mean for US companies?

US companies should stay abreast of IFRS developments, as several challenges require companies' attention on the IFRS front. Companies will encounter an unprecedented rate of financial reporting change as converged standards roll out over the next 2-3 years, in addition to addressing the continued adoption of IFRS by non-US subsidiaries.

Converting from local GAAP to either full IFRS or IFRS for SMEs requires a commitment of management focus, resources, and funding. The transition will have implications on processes, systems, people, and tax, and may be costly, complex, and time-consuming. However, as more non-US subsidiaries adopt IFRS, there may be considerable benefits to the company as a whole, for example streamlining their consolidation process. To maximize these benefits, US parent company corporate oversight is vital to ensure that there is a uniform approach to the adoption of IFRS across all subsidiaries.

Consistent with our overall recommendations that US companies should take a measured approach to IFRS transition in light of the current environment, we believe there are a number of steps you may want to take in the coming year to stay in front of the conversion process at your subsidiaries, including:

- Analyze and determine which version of IFRS is most appropriate for adoption by your subsidiaries. Oversee subsidiary adoption of IFRS. Closely monitor non-US subsidiaries' decisions and influence subsidiaries' transition timing and strategies.
- Identify policy decisions and ensure that the corporate headquarters accounting group is in control of the determination of IFRS policies. While consistency in application of IFRS by non-US subsidiaries is important, companies should not lose sight of the fact that country-specific factors may justify varying application, for example tax and/or dividend impacts. Thus, cost-benefit assessments may be needed for adoption of IFRS, IFRS for SMEs, or different versions of IFRS for SMEs within given jurisdictions.
- Identify key differences between local GAAP and IFRS and identify any broader impacts on people, systems, processes and tax. Ensure appropriate cross-functional stakeholders (e.g. IT or tax) are involved to ensure a full understanding of the broader impacts of the conversion is achieved.
- Provide appropriate training on IFRS and IFRS for SMEs to key stakeholders.
- With respect to the UK and any other jurisdiction that may follow the UK's lead, consider responding to questions raised in consultation papers if there are areas you believe need changes.

Initial IFRS adoption by non-US subsidiaries, in the UK for example, could also provide an opportunity for key corporate stakeholders to increase their IFRS knowledge through control over a live conversion project. Additionally, adoption by a UK subsidiary could be used as a pilot conversion project, to benefit subsidiaries in other territories by establishing the conversion processes to fine tune the understanding of the practical implications of certain accounting policy decisions and application in practice under IFRS or IFRS for SMEs. Consequently, companies may be able to develop a robust approach to the conversion process that can be duplicated for other territories.

In summary, by keeping apprised of developments with IFRS at home and abroad, US companies may ensure that they and their affiliates remain well positioned for ongoing global conversion, near-term US GAAP / IFRS convergence, as well as eventual US conversion to IFRS.

Additional resources are available to assist you in understanding IFRS for SMEs, including a high-level comparison of the rules under UK GAAP versus IFRS for SMEs for different financial statement items, as well as a "Similarities and Differences" guide comparing and contrasting full IFRS and IFRS for SMEs. These resources may be found on this publication's page on www.pwc.com/usifrs.

To have a deeper conversation about how this topic may affect your business and / or obtain further information, please visit our dedicated US IFRS website or contact one of the following:

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