

# What the new reporting framework means to you

The Zambia Institute of Chartered Accountants ("ZICA") recently announced the adoption of a tiered financial reporting framework to simplify and enhance compliance with financial reporting and to lower the cost of doing business. The tiered reporting framework comprises of International Financial Reporting Standards ("IFRS") as we have known them for many years, IFRS for Small and Medium-sized Entities ("SME's") and the newly introduced Financial Reporting Standard for Micro and Small Entities ("FRS for MSE's").

This article focuses on the latter standards (FRS for MSE's), which are unique to Zambia and which will have a significant impact on the reporting framework.

As a background, the three-tier framework will be effective for accounting periods commencing on or after 1 January 2011 and will be applied as follows:

Entity Type <sup>1</sup>	Applicable Framework
Listed companies, public interest entities and government institutions	Full IFRS
Economically significant entities that do not meet the definition of	IFRS for SMEs
Entities that are not economically significant or publically accountable	IFRS for SMEs

The standard has specified a threshold of K 20 billion based on turnover in order to determine whether an entity can apply the FRS for MSE's standard. The use of a single benchmark gives rise to the following challenges:

- Annual volatility in revenue/ turnover may result in regular changes to the applicable reporting framework;
- There is no guidance on how turnover is determined;

It would be prudent for multiple benchmarks to be considered in arriving at the decision of which standard an entity should apply.

Moving beyond the threshold, in principal, the new standard is a simplified version of the IFRS for SME. Without any doubt, this is a step in the right direction insofar as tailoring the financial reporting framework to meet the needs of small entities operating in Zambia. In a snapshot, the introduction of FRS for MSEs will result in;

- The elimination of fair value accounting and options. Only the cost basis of accounting is permitted;
- Some removal of accounting policy options;
- Reduced financial statement disclosures; and
- Potential exclusion of complex accounting topics;

You will note that the above developments are not absolute in their success. Why do we say that? Well, the underlying principal of the standards is that if you find yourself in a situation where your transaction is not covered by the standard, you will need to refer back to the full IFRS for guidance. So for example, the new standards have removed reference to transactions such as loans that include a 'facilitation fee' that is charged up front by the bank. Since this 'event' is not covered by FRS for MSE, the entity will need to refer to IFRS for guidance, bringing in the complications of fair value on recognition, which FRS for MSE standard was trying to eliminate.

We will dwell on some of the other changes in some level of detail.

For starters, the standard has eliminated selected disclosures from the financial statements thus simplifying their preparation. This may, however, deprive the users of information that is essential to understanding the business. Additionally, the approach adopted by the standard which results in prospective application of any changes in accounting policy may result in financial statements for two periods being significantly incomparable.

When it comes to fair value of assets, the framework considers the cost basis of accounting to be simpler and more objective as

November 2011

information about the fair value of assets and liabilities may not be readily available. However, it is arguable that cost does not necessarily represent the intrinsic value of assets, liabilities or the business as a whole.

On depreciable assets, the standard allows for only one basis of depreciation, Straight Line method. Whereas this is often regarded as the easiest method, in some instances, it does not appropriately reflect the pattern of asset utilisation. For example, for entities involved in mining, Units Of Production is generally considered more appropriate.

The standard has also eliminated the requirement to recognise deferred income tax. It should be noted that deferred income tax meets the definition of an asset or liability as it represents future tax receipts or payments based on transactions carried out by the entity. Therefore its exclusion is a contradiction. Additionally, users can expect that there will be increased volatility in their effective tax rate reported which may affect comparability.

With regards the statement of cash flows, the standard only allows for the direct method of determining the cash flows from operating activities. This method provides meaningful information for the financial statement users, but is generally considered tedious and is usually complicated.

In order to reduce the cost of doing business, the standard proposes that entities applying FRS for MSE be exempt from the requirement to have an audit preformed in accordance with international auditing standards. In order to achieve this, the Zambia Companies Act requires amendment. However, users of the financial statements, such as banks, may place limited reliance on unaudited financial statements presented to them which consequently may result in higher borrowing costs.

Overall, ZICA has demonstrated leadership in developing a new standard suited to Zambian entities. This is commendable. There is a need for all stakeholders to invest in understanding the impact of the new framework and, specifically, the implications of the FRS for MSEs. Users such as financial institutions will also need to realign their financial statement review processes to account for the changes to the basis of reporting.

## Detailed Impact Assessment Presentation of Financial Statements

Benefits	Challenges
The statement of changes in equity is no longer required. A complete set of financial statements comprises three primary statements plus the accounting policies and explanatory notes.	Whilst there is no requirement to present a Statement of changes in equity, disclosures of movements in equity will still be required; <ul style="list-style-type: none"> <li>Dividends and other movements in retained earnings will be on the Statement of Income;</li> <li>Any other changes in equity, will be shown in the notes.</li> </ul>
No restatement of comparatives is required on first time adoption of FRS for SMEs.	First time adoption balances may not be comparable with prior year financial statements.
Changes in accounting policy and correction of misstatements done prospectively.	Current and prior year amounts may not be comparable.
Fewer disclosures will simplify financial statements. The following are no longer required; <ul style="list-style-type: none"> <li>Comparatives for fixed assets</li> <li>Comparatives for intangible assets</li> <li>Statement of changes in equity</li> <li>Effective tax reconciliation</li> </ul>	The elimination of disclosures may affect the usefulness of financial statements for a number of stakeholders.

### Statement of Financial Position - Assets

Benefits	Challenges
The standard applies the principle of the lower of Cost or NRV to determining the carrying value of assets; <ul style="list-style-type: none"> <li>Assets are not fair valued.</li> <li>Depreciable assets are not revalued.</li> </ul>	Measurement at cost does not always reflect the value of the assets.
Depreciable assets, only straight line depreciation basis is allowed.	Other bases such as Units of Production may be more appropriate in certain instances, such as mining entities.
Accounting for biological assets has been simplified by narrowing it to the use of cost rather than fair value, less cost to complete.	Gaps in the standard with regards to the required treatment for areas such as 'offspring' or 'secondary crop' may result in the need to adopt full IFRS or IFRS for SME requirements.

### Statement of Financial Position - Liabilities

Benefits	Challenges
There is no requirement to fair value financial instruments such as accounts payable and loans/borrowings.	<ul style="list-style-type: none"> <li>Intrinsic value of liabilities may not be captured.</li> <li>The standard defines loans payable as amounts due after 12 months and excludes current liabilities.</li> <li>There is a requirement to disclose accounts payable outside agreed credit terms as at the Balance Sheet date. The requirement is unclear.</li> </ul>

### Statement of Income - Profit

Benefits	Challenges
Under the new standard, there is no requirement to recognise deferred tax on temporary differences.	Deferred tax meets the definition of an asset or a liability. Therefore, non-recognition with result in incomplete assets or liabilities.
	The effective tax rate for entities will be volatile.
The standard allows for exceptional items.	Exceptional items allow for manipulation of presentation of items.

### Statement of cash flows

Benefits	Challenges
Only the direct method for computing cash flows from operations is permitted. This provides more meaningful information for the users.	The direct method is tedious and usually complicated.