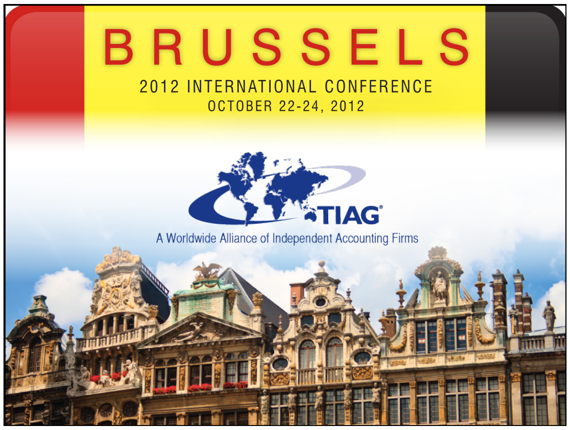

SME Accounting issues

Presented by:

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Introduction and objectives

IFRS in its' current form was designed to provide financial information useful for analysts when assessing listed entities.

USGAAP was developed to support SEC accounting and reporting regulations by listed entities in the USA.

Neither system is entirely 'fit for purpose' when applied by privately owned (proprietorial) Small and Medium Sized entities.

This session will look at the more likely problem areas and the emerging help and exemptions.

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Programme

- IFRS and USGAAP – current projects for exemptions for SMEs
- Main problem areas
  - Financial instrument accounting – too complex
  - Excessive, unnecessary disclosures
  - Accounting Standard complexity and length (overload)
  - IFRS/ GAAP v tax treatment
- Statutory initiatives
  - Audit exemptions
  - Micro entities

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SME accounting

IFRS and USGAAP current projects

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IFRS for SMEs

- Single 'Standard' alternative to full IFRS
- Same presentation requirements – final statements
- Comply with fundamental principles – fair presentation
- IFRS much less detailed and complex; but
- If in doubt – refer to full Standards

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FASB project – Private v Public company accounting

- Invitation for comment issued 31 July 2012 (comments by 31 October 2012)
- Initial thoughts on a different regime for recognition, measurement and presentation for private entities
  - Scope – who is private
  - Deferral from adoption new Accounting Standards
  - More relaxed transition rules
  - What are users' wants and needs?

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Scope?

- Listed on Regulated Market?
  - Public accountability?
- Based on legal exemptions for SMEs (Small and Medium Sized)
  - Turnover, assets and employees
- Who are the users?
  - Tax authorities

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SME accounting

Key areas of difficulty

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1. Financial instrument accounting

- Main focus of regulators
  - Banks and financial institutions
  - Insurers (at some point)
  - Multinational treasury functions
- Default requirement – recognition at fair value
- Gains and losses do not reflect cash flows
- Is the information necessary and useful?

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Financial instrument - example

European entity acquires inventory from the USA priced in $s. The latest consignment will cost $125,000 payable in 60 days.

The buying company enters into a currency forward contract with their bank buying $125,000 at a fixed price of €100,000 also payable in 60 days.

The company year end is after 30 days when the $:€ rate is €1 = $1.1

How should this transaction be accounted for at the year end?

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Financial instrument - solution

Cash based?

·Record inventory purchase at contract rate - €100,000
·State payable at this value at year end
·When bank contract funds ($125,000) at cost €100,000 cash use these funds to settle payable

Fair value/ GAAP

·Record inventory purchase at spot at delivery
·Record trade payable at spot at year end – with gain and loss from spot at invoice date
·Record currency contract at fair value (compared with year end forward rate)
·Record all gains and losses in net income

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2. Unnecessary and complex disclosures

- Significant judgements and estimations (in policies)
- Financial risks – ageing of receivables and provisions
- Impairment and other fair value information (pension disclosures?)
- Other possible developments
  - Corporate and social responsibility disclosures
  - Carbon emissions?
- What is the compliance problem for SMEs

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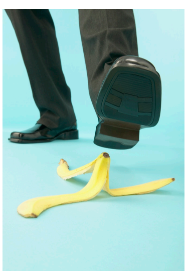
3. Accounting Standard complexity



- Precedents less readily available and perhaps excessive?
- Private entities lack the technical resource
- Reliance on external advisers/ auditors may create ethical conflicts
- Is the information really worth the effort?

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Complexity - illustration

- Trading Co sign 20 year lease to acquire office space costing €50,000 a year; they have the option to break the contract after 5 years.
- The landlord can adjust the rental payable after 5 years should Trading Co decide to remain in occupation.
- The landlord is providing the first 6 months of the lease rent free to allow Trading Co to establish themselves
- How do you think this agreement should be accounted for?

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Lease accounting options

Current

·Show rental expense straight line over life of the minimum lease term
– €45,000 p.a

·Disclose total remaining lease obligations at year end

Proposed

·Assess if lease consumes a not insignificant proportion of the asset economic value

·Always disclose asset and obligation on balance sheet at NPV at inception

·Depending on 1
– Allocate lease cost straight line; or
– Allocate amortisation and finance charge

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4. Who are the users?

- Credit rating agencies
- Tax authorities
- Shareholders and minorities detached from management
- Landlords and other suppliers
- How do their needs compare with those of financial analysts?

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Key areas for confusion/ misunderstanding

- Non-recurring unusual and exceptional items
- Realised compared with unrealised losses
  – Asset write downs and impairments
  – Goodwill impairment or amortisation
- Financial liabilities – distinction between current and long term
- Financial 'drawings' of owners and managers

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Statutory exemptions

Help at hand?

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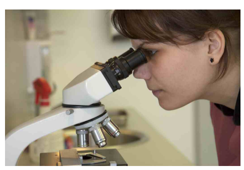
Micro entities

- Exempt from all accounting and audit requirements
- Simple balance sheet and profit and loss account to comply with the minimum legal requirements
- Exemptions will be optional – company and users can always ask for more



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Increased exemptions from audit

- All small entities as defined
- All dormant entities
- Subsidiaries
  - All subsidiaries as long as group statements are audited
  - Subsidiaries if liabilities guaranteed by the parent company

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Narrative reporting

- Have a different regime for listed entities only
  - Business reviews (Management Discussion and Analysis)
  - Directors' remuneration
  - Strategy and forward looking statements
- SMEs to produce just factual information (mainly)

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Final thoughts

- Are complaints about IFRS v GAAP more a question of laziness on the part of preparers rather than inappropriate Standards
- There can be only one 'true and fair view'/ 'fair presentation'
- Shouldn't a qualified accountant and auditor know what is required by Accounting Standards
- Excessive complexity is just evidence of materiality not being properly applied
- Business is becoming increasingly complex, so must Standards

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Many thanks and enjoy the rest of the conference

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