IAS 39 Financial Instruments: Recognition and Measurement

The users of SMEs financial statements generally need to perform a simple analysis of the data of each company but often require reproducing it over a large number of small companies, so that the disclosure of quantitative information is less relevant than for publicly accountable companies. Therefore, this standard should be simplified in following areas:

- Classification of financial instruments. Financial instruments that meet specified criteria should be measured at cost or amortized cost; all others should be measured at fair value trough profit or loss for SMEs. The other classification of IAS 39 should not be available.
- Derecognition. Derecognition should be simplified because provisions applied under IAS 39 are complex and related to derecognition transactions which SMEs are typically not engaged
- Hedge accounting. The attention should be paid to the types of hedging that SMEs are likely to do, specially hedges of: interest rate of a debt instruments measured at amortized cost, foreign exchange risk or interest rate risk in a firm commitment or a highly probable forecast transaction, price risk of commodity that is hold or in a firm commitment or a highly probable forecast transaction to purchase or sell a commodity or foreign exchange risk in a net investment in a foreign operation. For SMEs should be required periodic recognition and measurement of hedge ineffectiveness, but under less strict conditions than in IAS 39.

Goodwill impairment

Annual calculation of the recoverable amount of goodwill is onerous for SMEs because of expertise and cost involved. SMEs should be required to calculate the recoverable amount of goodwill only if impairment is indicated. The IFRS for SMEs should use an indicator approach and include a list of indicators based on internal and external sources of information. The second way is an amortization approach to goodwill impairment. It is more complex approach; amortization of goodwill could be required over specified maximum period (from 10 to 20 years).

Research and development costs

Under IAS 38 all research cost are charged to expenses when incurred, but development costs incurred after the project is deemed to be commercially viable are to be capitalized. SMEs could choose an accounting policy for treating all research and development costs and expenses (not available under IAS38).

Share-based payment

IFRS 2 generally requires measurement by reference to the fair value of the equity instruments granted. There should be provided appropriate simplifications for SMEs.

IAS-17 Leases

The IAS 17 requires a lessee to measure rights and obligations under a finance lease at an amount equal to the fair value of the leased property. IAS 17 requires two measurements (The fair value and the present value of the leased property) and to use the lower of them. The measurement for SMEs should be simplified, only the fair value of the leased property should be used for determination at the inception of lease.

Topics to be omitted from IFRS for SMEs

There are some topics that should not be covered by IFRS for SMEs, but for which it includes a cross-reference to the relevant IFRS that an entity would be required to apply if it encountered the transaction or situation.

IAS 29- Financial Reporting in Hyperinflationary Economics

The SMEs whose currency is the currency of hyperinflationary economy should apply the full IAS 29 in preparing and presenting financial statement in accordance with IFRS for SMEs. It is uncommon for SMEs to have a hyperinflationary functional currency; this is the reason for omitting these standards from IFRS for SMes.

IAS 34- Interim Financial Reporting

There is an opinion that most SMEs would not issue interim financial reports or would issue interim financial reports that are not described as complying with a the IFRS for SMEs. The SME could choose whether use full IAS 34 or SME use its prior annual financial statement s as its comparative prior period information (in case of business combination).

IAS 41- Agriculture

There should be determined biological assets and their measurement for entities using IFRS for SMEs that is engaged in agricultural activities in IFRS for SMEs. The SME should apply the fair value model for

those biological assets whose fair value is readily determinable (IAS 41). SMEs should measure those biological assets whose fair value is not readily determinable at costs less accumulated depreciation. Agriculture produce should be measured at fair value less estimated point-of-sale costs at the point of harvest.

IAS 17- Leasing - Lessor accounting for finance leases

Many lessors in a finance lease are financial institutions that are publicly accountable and, thus, would not be eligible to use IFRS for SMEs.

IAS 33 - Earnings per Share

There is not required to present amounts of earnings per share. However, an SME that discloses earnings per share shall calculate and disclose earnings per share in accordance with IAS 33.

IAS 14 - Segment Reporting

An SME is not required to present segment information. An SME that elects to disclose segment information should follow the full IAS 14.

Results of designed modification can be summed up in the following table:

Table 1. Survey of possible modification of each standard

Standard	Name	Simplification	Omitting
IAS 1	Presentation of Financial Statements	+	
IAS 2	Inventories		
IAS 7	Cash Flow Statement	+	
IAS 8	Accounting Policie, Estimates and Errors	+	
IAS 10	Events after the End of the Reporting Period		
IAS 11	Construction Contracts	+	
IAS 12	Income Taxes	+	
IAS 14	Segment Reporting		+
IAS 16	Property, Plant and Equipment	+	
IAS 17	Leases	+	
IAS 18	Revenue		
IAS 19	Employee Benefits	+	
IAS 20	Government Grants	+	
IAS 21	The Effect of Changing Foreign Exchange Mates	+	
IAS 23	Borrowing Costs	+	
IAS 24	Related Party Dislosures	+	
IAS 26	Accounting and Reporting for Retirement Benefit Plans	+	
IAS 27	Consolidated Financial Statements	+	
IAS 28	Investment in Associates	+	
IAS 29	Hyperinflation		+
IAS 30	Disclosure in Financial Statement of Banks in Similar Financial Instituitions		+
IAS 31	Investment in Joint Ventures	+	
IAS 32	Financial Instruments: Presentation	+	
IAS 33	Earnings per Share		+
IAS 34	Interim Reporting		+
IAS 37	Provisions and Contingecies	+	
IAS 38	Intangible Assets	+	
IAS 39	Financial Instruments: Recognition and Measurement	+	
IAS 40	Investmet Properte	+	
IAS 41	Agriculture		+
IFRS 1	First-time Adoption of IFRS	+	
IFRS 2	Equity-settled share based payment		+
IFRS 3	Business Combinations	+	
IFRS 4	Insurance Contracts	+	
IFRS 5	Non-current Assets Held for Sale and Discountinued Operations	+	
IFRS 6	Exploration for and Evaluation af Mineral Resources		+
IFRS 7	Financial Instruments: Disclosures	+	

Source: Own approach to modification of IFRS for SMEs

Conclusion

IFRS for SMEs should be designed to apply to the general purpose harmonized financial statements and other financial reporting of all profit-oriented SMEs. General purpose financial statements are directed toward the common information needs (an entity´s financial position, performance, cash flow) of a wide range of users (shareholders, creditors, employees).

Determination of taxable income requires special purpose financial statements designed to comply with the tax laws and regulations in a particular jurisdiction. The financial statements especially profit or loss prepared in accordance with IFRS for SMEs could serve as the starting point for taxable income determination in each country.

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THE POSSIBLE TRANSFORMATION OF INTERNATIONAL REPORTINGSTANDARDS (IFRS) FOR SMALL AND MEDIUM-SIZED ENTERPRISES (SME)

Summary

There are 5 000 000 business entities in Europe, but only 9 000 prepare financial statements that comply with the full International Financial Reporting Standards (IFRS) developed primarily for use on international capital markets. The most of the others are small or medium-sized enterprises (SME) which have a legal obligation to prepare financial statements in accordance with a set of accounting principles accepted in their country. Those statements are available to creditors, suppliers, government in their country, but they could be badly understandable to creditors, suppliers and others in other countries. This is the great obstacle to their activity on the internal market. The most important obstacles can be considered 27 different national accounting systems in the EU.

Despite the fact that the SMEs are not defined in all countries by the same way yet, it is a necessity to develop financial reporting standards for those entities. There are many ways how to develop accounting standards compatible for SMEs, but most significant activity in this field is the research project of IASB (International Accounting Standards Board). IASB has developed IFRS. Even though IFRS are suitable for all the entities, their application in case of SMEs would be very expensive and could increase compliance costs of taxation significantly.

The development has not finished yet and there has arisen some problems which need to be solved before accounting standards introduction to the public.

The research has shown that IFRS for SMEs should be used mainly by the entities which do not have public accountability – i.e. that its equities are not publicly traded and do not hold assets in a fiduciary capacity for a broad group of outsiders. The paper presents the IFRS modifications which are needed to be done in case of SMEs. Firstly, there are presented topics which can be fully omitted from IFRS in case of SMEs (for example interim reporting – IAS 34, equity-settled share-based payment – IFRS 2, extractive industries – IFRS 6, etc.). Secondly, the paper presents the topics of IFRS in which the simplification is needed to be done in case of SMEs. Only the simple option in IFRS should be used by SMEs (for example in case of IAS 40 – only the cost-depreciation model for investment property should be used, in acse of IAS 23 – borrowing costs should be reported as expense, capitalization should not be allowed, etc.). At the end, the paper presents the methods for simplification of recognition and measurement for SMEs.

The paper is aimed to the main differences between the IFRS and standards for SMEs. It is the part of the research done in the project GA CR no. 402/07/0547 “The Impact of Financial Reporting Harmonization for Small and Medium-sized Enterprises in Relation to the Income Tax Base Construction”.