About the course

Literature

- International financial reporting standard for small and medium-sized entities (IFRS for SMEs). London: International Accounting Standards Board, 2009. 230 s. ISBN 9781907026171. Available at: http://eifrs.iasb.org/eifrs/sme/en/IFRSforSMEs2009.pdf

- IFRS Foundation: Training Material for the IFRS for SMEs. London: International Accounting Standards Board. Available at: http://www.ifrs.org/IFRS-for-SMEs/Pages/Training-Modules.aspx

Requirements for successful accomplishment of the course

- 85% participation at seminars (i.e. absence at max 2 seminars is excused)
- 1 presentation of theory or practice during the semester (if by the end of the semester a student doesn't have a presentation, 10 points will be deducted from total number of points received from both mid-semester tests). In case of practical presentation (i.e. exercise), the exercise is chosen by a student or by a lector always minimally one week in advance. Unless the student is excused (he/she is ill), the student has to present the exercise at specified date. Topics for theoretical presentations should be agreed with a lecturer at the beginning of the semester.
- Two control tests, minimum required amount is 60% of correct answers. Points from two tests are accumulated. Tests contain theoretical (questions) and practical part (exercises).
- Final test is a written exam

Attention! Claim for final exam: getting a minimum amount of points from two control tests is a necessary requirement for being eligible to take a final exam.

Introduction

1.1. IASB, IFRS, IFRS vs. GAAP

The International Accounting Standards Board (IASB) was established in 2001 as part of the **International Accounting Standards Committee (IASC) Foundation.**

The **objectives** of the IASC Foundation and of the IASB are:

(a) to develop a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;

(b) to promote the use and rigorous application of those standards;

(c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and

(d) to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.

The IASB is the **standard-setting body** of the IASC Foundation, that is, the IASB is responsible for approving **International Financial Reporting Standards (IFRSs, including Interpretations)** and related documents, such as the **Framework for the Preparation and Presentation of Financial Statements**, exposure drafts and discussion documents. Before the IASB began operations, International Accounting Standards (IASs) and related Interpretations were established by the Board of IASC, which came into existence on 29 June 1973. By resolution of the IASB, IASs and related Interpretations remain applicable, with the same authority as IFRSs developed by the IASB, unless and until they are amended or withdrawn by the IASB.

The **IASB achieves its objectives primarily by developing and publishing IFRSs and promoting the use of those standards in general purpose financial statements and other financial reporting**. Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions.

IFRSs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and other events and conditions that are important in general purpose financial statements. They may also set out such requirements for transactions, events and conditions that arise mainly in specific industries. **IFRSs are based on the Framework**, which addresses the concepts underlying the information presented in general purpose financial statements. **The objective of the Framework is to facilitate the consistent and logical formulation of IFRSs. It also provides a basis for the use of judgement in resolving accounting issues.**

IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. General purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. **The objective of financial statements is to provide information about the financial position, performance and cash flows of an entity that is useful to those users in making economic decisions.**

"Accounting policy is one of the most difficult and controversial topics to deal with. It is the same around the world", - Hans Hoogervorst, Chairman of IASB, June 2012

"Transparency is not just a buzz word or a cliché. It is a fundamental and absolutely essential attribute of sound financial markets. Relevant, trustworthy, and timely information is the oxygen of financial markets", - Robert H. Herz, Chairman of FASB, June 2009

Goals of FASB and IASB - the highest relevance, representational faithfulness, transparency and comparability of accounting information =>

Memorandum of understanding or Norwalk Agreement (2002) and removal of obligation of US GAAP reconciliation (2007) – "Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to US GAAP"

General comparison of US GAAP and IAS/IFRS:

US GAAP:	IFRS:
• rules-based	• principles-based
• procedure-oriented	• objective-oriented
• emphasis on best practice	• emphasis on professional judgment

US GAAP – too complicated and expensive for application (approx. 25 000 pages). IFRS – simplified version of US GAAP (approx. 3000 pages) based on pan-European (in fact, British) accounting best practices.

1.2. International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs)

The IASB also develops and publishes a separate standard intended to apply to the general purpose financial statements of, and other financial reporting by, entities that in many countries are referred to by a variety of terms, including **small and medium-sized entities (SMEs), private entities, and non-publicly accountable entities.** That standard is the **International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).**

Many jurisdictions around the world have developed their own definitions of SMEs for a broad range of purposes. Often those national or regional definitions include quantified criteria based on revenue, assets, employees or other factors. Frequently, the term SMEs is used to mean or to include very small

entities without regard to whether they publish general purpose financial statements for external users. SMEs often produce financial statements only for the use of owner-managers or only for the use of tax authorities or other governmental authorities. Financial statements produced solely for those purposes are not necessarily general purpose financial statements.

The term **small and medium-sized entities** as used by the IASB is defined as entities that:

(a) do not have public accountability, and

(b) publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

The Fourth Accounting Directive of EC allows Member States to prescribe lighter reporting regimes for SMEs, which are defined as following:

	Micro	Small	Medium-sized
Balance sheet total	≤ € 500 000	≤ € 4 400 000	≤ € 17 500 000
Net turnover	≤ € 1 000 000	≤ € 8 800 000	≤ € 35 000 000
Average number of employees during the financial year	≤ 10	≤ 50	≤ 250

An entity has public accountability if:

(a) its **debt or equity instruments are traded in a public market** or it is **in the process of issuing such instruments for trading in a public market** (i.e. a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(b) it holds assets in a **fiduciary capacity** for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

Some entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity (i.e. AUM). However, if they do so for reasons incidental to a primary business, that does not make them publicly accountable.

A subsidiary whose parent uses full IFRSs, or that is part of a consolidated group that uses full IFRSs, is not prohibited from using IFRS for SMEs in its own financial statements if that subsidiary by itself does not have public accountability. However, if its financial statements are described as conforming to the IFRS for SMEs, it must comply with all of the provisions these IFRS.

Tax laws are specific to each jurisdiction, and the objectives of general purpose financial reports differ from the objectives of reporting taxable profit. Thus, **financial statements prepared in conformity with the IFRS for SMEs are unlikely to comply fully with all of the measurements required by a jurisdiction's tax laws and regulations.** A jurisdiction may be able to lessen the 'dual reporting burden' on SMEs by

structuring tax reports as reconciliations from the profit or loss determined in accordance with the IFRS for SMEs and by other means.

Decisions on which entities are required or permitted to use full IFRS or IFRS for SMEs rest with legislative and regulatory authorities and standard-setters in individual jurisdictions.

Concepts and Principles (the same as The Conceptual Framework for Financial Reporting for full IFRS)

1.1. Objective of financial statements of SME

The objective of financial statements of SME is to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Financial statements also **show the results of the stewardship of management**, that is, **the accountability of management for the resources entrusted to it.**

1.2. Qualitative characteristics of information in financial statements

Understandability – the information provided in financial statements should be presented in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, the need for understandability does not allow relevant information to be omitted on the grounds that it may be too difficult for some users to understand.

Relevance – the information provided in financial statements must be relevant to the decision-making needs of users. Information has the quality of relevance when it is capable of influencing the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

Materiality – information is material - and therefore has relevance - if its omission or misstatement could influence the economic decisions of users made on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. However, it is inappropriate to make, or leave uncorrected, immaterial departures from the IFRS for SMEs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Reliability – the information provided in financial statements must be reliable, that is, it should be free from material error and bias and represents faithfully that which it either purports to represent or could reasonably be expected to represent. Financial statements are not free from bias (i.e. not neutral) if, by the selection or presentation of information, they are intended to influence the making of a decision or judgements in order to achieve a predetermined result or outcome.

Substance over form – transactions and other events and conditions should be accounted for and presented in accordance with their substance and not merely their legal form. This enhances the reliability of financial statements.

Prudence – the uncertainties that inevitably surround many events and circumstances are acknowledged by the disclosure of their nature and extent and by the exercise of prudence in the

preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias.

Completeness – to be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Comparability – users must be able to compare the financial statements of an entity through time to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities to evaluate their relative financial position, performance and cash flows. Hence, the measurement and display of the financial effects of like transactions and other events and conditions must be carried out in a consistent way throughout an entity and over time for that entity, and in a consistent way across entities. In addition, users must be informed of the accounting policies employed in the preparation of the financial statements, and of any changes in those policies and the effects of such changes.

Timeliness – to be relevant, financial information must be able to influence the economic decisions of users. Timeliness involves providing the information within the decision time frame. If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the needs of users in making economic decisions.

Balance between benefit and cost – the benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs are not necessarily borne by those users who enjoy the benefits, and often the benefits of the information are enjoyed by a broad range of external users. Financial reporting information helps capital providers make better decisions, which results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. Individual entities also enjoy benefits, including improved access to capital markets, favourable effect on public relations, and perhaps lower costs of capital. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for general purpose financial reporting purposes.

1.3. Financial position

The financial position of an entity is the relationship of its assets, liabilities and equity as of a specific date as presented in the **statement of financial position**. These are defined as follows:

(a) Asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

(b) Liability is a present obligation of the entity arising from past events, settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

(c) Equity is the residual interest in the assets of the entity after deducting all its liabilities.

Some items that meet the definition of an asset or a liability may not be recognized as assets or liabilities in the statement of financial position because they do not satisfy the criteria for recognition as they are defined in IFRS for SMEs. **In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion before an asset or liability is recognized.**

Further IFRS for SMEs provide following guidance for assets to be recognized as assets:

(a) **The future economic benefit of an asset** is its potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. Those cash flows may come from using the asset or from disposing of it.

(b) Many assets, for example property, plant and equipment, have a physical form. However, **physical form is not essential to the existence of an asset**. Some assets are intangible.

(c) In determining the existence of an asset, **the right of ownership is not essential**. Thus, for example, property held on a lease is an asset if the entity controls the benefits that are expected to flow from the property.

Further IFRS for SMEs provide following guidance for liabilities to be recognized as liabilities:

(a) An **essential characteristic of a liability is that the entity has a present obligation to act or perform in a particular way**. The obligation may be either a **legal obligation** or a **constructive obligation.**

(i) A legal obligation is legally enforceable as **a consequence of a binding contract or statutory requirement.**

(ii) A constructive obligation is **an obligation that derives from an entity's actions** when **by an established pattern of past practice**, published policies or a sufficiently specific current statement, **the entity has indicated to other parties that it will accept particular responsibilities**, and, as a result, **the entity has created a valid expectation on the part of those other parties that it will discharge (fulfill) those responsibilities**.

(b) The settlement of a present obligation usually involves the payment of cash, transfer of other assets, provision of services, the replacement of that obligation with another obligation, or conversion of the obligation to equity. An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

Further IFRS for SMEs provide following guidance for equity to be recognized as equity:

(a) Equity is the residual of recognized assets minus recognized liabilities.

(b) It may be subclassified in the statement of financial position. For example, in a corporate entity, subclassifications may include **funds contributed by shareholders, retained earnings and gains or losses recognized directly in equity.**

1.4. Performance

Performance is the relationship of the income and expenses of an entity during a reporting period. IFRS for SMEs permits entities to present performance in **a single financial statement (a statement of comprehensive income)** or **in two financial statements (an income statement and a statement of comprehensive income).**

Total comprehensive income and profit or loss are frequently used as measures of performance or as the basis for other measures, such as return on investment or earnings per share.

Income and expenses are defined as follows:

(a) Income is increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors. The definition of income encompasses both revenue and gains:

(i) **Revenue is income that arises in the course of the ordinary activities of an entity** and is referred to by a variety of names including **sales, fees, interest, dividends, royalties and rent.**

(ii) **Gains are other items that meet the definition of income but are not revenue**. When gains are recognized in the statement of comprehensive income, they are usually displayed separately because knowledge of them is useful for making economic decisions.

(b) Expenses are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors. The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity.

(i) **Expenses that arise in the course of the ordinary activities** of the entity include, for example, **cost of sales, wages and depreciation**. They usually take the form of an **outflow or depletion of assets** such as cash and cash equivalents, inventory, or property, plant and equipment.

(ii) **Losses are other items that meet the definition of expenses and may arise in the course of the ordinary activities** of the entity. When losses are recognized in the statement of comprehensive income, they are usually presented separately because knowledge of them is useful for making economic decisions.

1.5. Recognition of assets, liabilities, income and expenses (general principles)

Recognition is the process of incorporating in the financial statements an item that meets the definition of an asset, liability, income or expense and satisfies the following criteria:

(a) it is probable that any future economic benefit associated with the item will flow to or from the entity - the concept of probability is used in the first recognition criterion to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence relating to conditions at the end of the reporting period available when the financial statements are prepared. Those assessments are made individually for individually significant items, and for a group for a large population of individually insignificant items.

(b) the item has a cost or value that can be measured reliably - in many cases, the cost or value of an item is known. In other cases it must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When a reasonable estimate cannot be made, the item is not recognized in the financial statements.

An item that fails to meet the recognition criteria may qualify for recognition at a later date as a result of subsequent circumstances or events. An item that fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes or explanatory material or in supplementary schedules.

1.6. Measurement of assets, liabilities, income and expenses (general principles)

Measurement is the process of determining the monetary amounts at which an entity measures assets, liabilities, income and expenses in its financial statements. Measurement involves the selection of a basis of measurement. Two common measurement bases are:

(a) Historical cost:

(i) for assets - it is the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire the asset at the time of its acquisition.

(ii) for liabilities - it is the amount of proceeds of cash or cash equivalents received or the fair value of non-cash assets received in exchange for the obligation at the time the obligation is incurred, or in some circumstances (for example, income tax) the amounts

of cash or cash equivalents expected to be paid to settle the liability in the normal course of business.

Amortized historical cost is the historical cost of an asset or liability plus or minus that portion of its historical cost previously recognized as expense or income.

(b) Fair value – it is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

1.7. Pervasive recognition and measurement principles, Accrual basis

The requirements for recognizing and measuring assets, liabilities, income and expenses are based on **pervasive principles** that are derived from the IASB Framework for the Preparation and Presentation of Financial Statements and from full IFRSs.

An entity shall prepare its financial statements, except for cash flow information, using the **accrual basis of accounting.** On the accrual basis, items are recognized as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for those items.

1.8. Recognition in financial statements

An entity shall recognize an asset in the statement of financial position **when it is probable that the future economic benefits will flow** to the entity and the asset has a cost or value that can be measured reliably. **An asset is not recognized** in the statement of financial position when expenditure has been incurred for which it is considered **not probable that economic benefits will flow** to the entity beyond the current reporting period. Instead such a transaction results in the recognition of an expense in the statement of comprehensive income (or in the income statement, if presented).

An entity shall not recognize a contingent asset as an asset. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and **its recognition is appropriate**.

An entity shall recognize a liability in the statement of financial position **when**:

(a) the entity has an **obligation at the end of the reporting period as a result of a past event**,

(b) **it is probable** that **the entity will be required to transfer resources embodying economic benefits in settlement**, and

(c) **the settlement amount can be measured reliably**.

A contingent liability is either a possible but uncertain obligation or a present obligation that **is not recognized** because it fails to meet one or both of recognition conditions. An entity shall not recognize a contingent liability as a liability, **except for contingent liabilities of an acquiree in a business combination.**

The recognition of income results directly from the recognition and measurement of assets and liabilities. An entity shall recognize income in the statement of comprehensive income (or in the income statement, if presented) **when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.**

The recognition of expenses results directly from the recognition and measurement of assets and liabilities. An entity shall recognize expenses in the statement of comprehensive income (or in the income statement, if presented) **when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.**

Total comprehensive income is the arithmetical difference between income and expenses. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.

Profit or loss is the arithmetical difference between income and expenses other than those items of income and expense that IFRS for SMEs classifies as items of other comprehensive income. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.

This IFRS does not allow the recognition of items in the statement of financial position that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the 'matching concept' for measuring profit or loss.

1.8. Measurement at initial recognition and subsequent measurement

At initial recognition an entity shall measure assets and liabilities at historical cost unless IFRS for SMEs requires initial measurement on another basis such as fair value.

During subsequent measurement it is necessary to distinguish between financial and non-financial assets and liabilities. **Basic financial assets and basic financial liabilities** are subsequently measured at **amortized cost less impairment,** except for investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are publicly traded or whose fair value can otherwise be measured reliably, which are measured at fair value with changes in fair value recognized in profit or loss. **An entity generally measures all other financial assets and financial liabilities at fair value**, with changes in fair value recognized in profit or loss, unless these IFRS requires or permits measurement on another basis such as cost or amortized cost.

Most non-financial assets that an entity initially recognized at historical cost **are subsequently measured on other measurement bases**. For example:

(a) An entity measures **property, plant and equipment at the lower of depreciated cost and recoverable amount.**

(b) An entity measures **inventories at the lower of cost and selling price less costs to complete and sell.**

(c) An entity recognizes **an impairment loss relating to non-financial assets that are in use or held for sale.**

Measurement of assets at those lower amounts is intended to ensure that an asset is not measured at an amount greater than the entity expects to recover from the sale or use of that asset. For the following types of non-financial assets, IFRS for SMEs permit or require measurement at fair value:

(a) investments in associates and joint ventures that an entity measures at fair value

(b) investment property that an entity measures at fair value

(c) agricultural assets (biological assets and agricultural produce at the point of harvest) that an entity measures at fair value less estimated costs to sell

Most liabilities other than financial liabilities are measured at the best estimate of the amount that would be required to settle the obligation at the reporting date.

1.10. Offsetting

An entity shall not offset assets and liabilities, or income and expenses, unless required or permitted by IFRS for SMEs.

(a) Measuring assets net of valuation allowances – for example, allowances for inventory obsolescence and allowances for uncollectible receivables – is not offsetting.

(b) If an entity's normal operating activities do not include buying and selling non-current assets, including investments and operating assets, then the entity reports gains and losses on disposal of such assets by deducting from the proceeds on disposal the carrying amount of the asset and related selling expenses.