Accounting (Basics) - Lecture 1

# IFRS for SMEs

# 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

# About the course

- Requirements for successful accomplishment of the course:
  - 85% participation of seminars is required (i.e. absence at max 2 seminars is allowed)
  - 60% of final grade can be received during final exam and 40% of final grade can be received during seminars. 40% is splitted into 2 midterm tests (10% each) and 1 presentation (20%) or activity at the seminars (20%).
  - In case of practical presentation (i.e. exercise), the exercise is chosen by a student or by a lecturer 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 midterm tests, minimum required amount is 60% of correct answers. Tests contain theoretical (questions) and practical part (exercises).
  - Final test is a written exam.

# Content

- Accounting phenomena
- Regulation – organizations and pronouncements
- International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs)

# Accounting phenomena – history (emergence of acc-g)

- **Scribes of ancient times** - Accountants existed in ancient China and Egypt. They were supervisors of the accounts of the Chinese Emperor and the Egyptian Pharaoh.
- **Profit maximization and double entry** - The attitude of profit maximization emerged at the end of the Middle Ages, with the emergence of large merchant houses in Italy. Trading was no longer the domain of the individual commercial traveler; it was now coordinated centrally at the luxurious desks of the large merchant houses in Venice, Florence or Pisa. Double-entry was introduced.
- **Economic conditions for financial reporting** - The practice of modern financial reporting dates back to the beginning of the modern corporation at the dawn of the Industrial Revolution. In 1853, the Society of Accountants was founded in Edinburgh. Further developments of the separation between provision of capital and management led to a steady growth of the accounting profession and regulation.

# Accounting phenomena – history (emergence of acc-g)

Companies across the world experienced growth in technology, improvement in communications and transportation, and the exploitation of expanding worldwide markets. As a result, the demands of owner-managed enterprises for capital rapidly exceeded the combined resources of the owners’ savings and the wealth-creating potential of the enterprises themselves. Capital markets were introduced.

Investors and creditors may have different objectives than management. Investors and creditors decisions about financing of certain business depend on true and fair view of business provided by its financial statements. To give such a view of a business in its financial statements, the best accounting and financial reporting practices were codified in a form of a set of accounting and financial reporting standards, first at national and latter at international level.

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# Accounting phenomena – role of int. fin. reporting standards

- **Information risk theory** - to illustrate the need for international financial reporting standards, consider the decision of a bank officer in making a loan to a business. If the bank makes the loan, it will charge a rate of interest determined primarily by three factors: (1) Risk-free interest rate; (2) Business risk for the customer; (3) Information risk. The latter – information risk - reflects the possibility that the information upon which the business risk decision was made was inaccurate. A likely cause of the information risk is the possibility of inaccurate financial statements. International financial reporting standards have no effect on either the risk-free interest rate or business risk, but they can have a significant effect on information risk. If the bank officer is satisfied that there is minimal information risk because a borrower's financial statements are prepared in accordance with best world financial reporting practices, the bank's risk is substantially reduced and the overall interest rate to the borrower can be reduced. The reduction of information risk can have a significant effect on the borrower's ability to obtain capital at a reasonable cost

# Accounting phenomena – role of int. fin. reporting standards

*“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

# Regulation – IASB (nature, objectives)

- 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) **to take account of the special needs of SM entities** and emerging economies; and

# Regulation – IASB (functions)

d) **to bring about convergence** of national accounting standards and IAS and IFRS to high quality solutions.

- **IASB is the standard-setting body of the IASC Foundation** - it is responsible for approving **IFRS** (including Interpretations) and related documents, such as the **Framework** for the Preparation and Presentation of Financial Statements, exposure drafts and discussion documents.
- The IASB achieves its objectives primarily by **developing and publishing IFRS** and promoting the use of those standards in **general purpose financial statements** and other financial reporting.
- IAS and related Interpretations, which were adopted before IFRS were developed, remain applicable with the same authority as IFRS, unless and until they are amended or withdrawn by the IASB.

# Regulation - IFRS

- **IFRS set out recognition, measurement, presentation and disclosure requirements dealing with transactions and other events and conditions that are important in general purpose financial statements.**
- IFRS are based on the Framework. The objective of the Framework is to facilitate the consistent and logical formulation of IFRS. It also provides a basis for the use of judgment in resolving accounting issues.
- IFRS are designed to apply to the general purpose financial statements and other financial reporting of **all profit-oriented entities**. 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.

# Regulation - IFRS vs. GAAP

- *"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
- 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<br>• procedure-oriented | • principles-based<br>• objective-oriented |

# IFRS for SMEs – def. and public accountability

- **International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs) are designed for small and medium-sized entities (SMEs), private entities, and non-publicly accountable entities.**
- 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.
- 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, or
  b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

# IFRS for SMEs – SMEs

- 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 |

# IFRS for SMEs - notes to individual cases

- Some entities may hold assets in a fiduciary capacity for a broad group of outsiders (e.g. AUM). 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.
- 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.
- 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.