

# Statement of Generally Accepted Accounting Practice for Small and Medium-sized Entities (SMEs)

## Introduction

On 7 August 2007 the Accounting Practices Board (APB) approved the .01 International Accounting Standards Board's (IASB's) exposure draft on *IFRS for SMEs*, without any change to the original text, as the South African Statement of Generally Accepted Accounting Practice for Small and Medium-sized Entities (Statement of GAAP for SMEs). All references to 'IFRS for SMEs' in that document should therefore be read as the 'Statement of GAAP for SMEs'.

This circular addresses the following areas: .02

- Current and future classifications of companies in the context of the corporate law reform process;
- The scope and effective date of the Statement of GAAP for SMEs;
- Financial reporting frameworks for 'limited interest companies';
- Development of the Statement of GAAP for SMEs;
- Some areas to be aware of in applying the Statement of GAAP for SMEs; and
- Audit reporting considerations.

## Current classification of companies in terms of the Companies Act, 1973

Section 19 of the Companies Act indicates that there are two types of .03 companies that can be incorporated in terms of the Companies Act:

- A company with a share capital; and
- A company without a share capital and having the liability of its members limited by the memorandum of association.

Companies with a share capital are then classified as either public .04 companies or private companies. All companies without a share capital are classified as public companies.

**Classification of companies and financial reporting in terms of the Corporate Laws Amendment Act, 2006**

- .05 The Corporate Laws Amendment Act was signed into law on 17 April 2007, but, at the time of issuance of this circular, its effective date has not yet been promulgated. The Amendment Act further classifies companies either as 'widely held' or 'limited interest'.

The Corporate Laws Amendment Act defines these companies as follows:

- (a) *"A company is a widely held company: if–*  
(i) *its articles provide for an unrestricted transfer of its shares;*  
(ii) *it is permitted by its articles to offer shares to the public;*  
(iii) *it decides by special resolution to be a widely held company; or*  
(iv) *it is a subsidiary of a company described in subparagraph (i), (ii), or (iii).*
- (b) *A company with two or more types of classes of shares is a widely held company if its articles provide for the unrestricted transfer of shares in one or more of these types or classes."*
- (d) *"A company is a limited interest company if it is not a widely held company."*

- .06 The Corporate Laws Amendment Act introduces a new section 285A to the Companies Act, 1973 and subsection 2 states, *"a limited interest company –*

- (a) *must comply with accounting standards developed for limited interest companies under section 440S(1)(b);*
- (b) *must comply with the provisions of this Act and Schedule 4 that are applicable to limited interest companies;*
- (c) *must prepare financial statements that fairly present the financial position and the results of operations of the company (and its subsidiaries, if applicable) in accordance with paragraphs (a) and (b)."*

- .07 However, as accounting standards have not yet been developed for 'limited interest companies', the following transitional provisions apply in terms of section 56(3)(a) of the Corporate Laws Amendment Act:

*“Prior to the development of accounting standards contemplated in section 285A(2)(a), a limited interest company must prepare its financial statements in accordance with a set of accounting practices adopted by that company, which must comply with the framework for the preparation and presentation of financial statements included in financial reporting standards.”*

### **The scope paragraph within the Statement of GAAP for SMEs**

Section 1 of the Statement of GAAP for SMEs states: .08

*“1.1 The IFRS for SMEs is intended for use by small and medium-sized entities (SMEs). SMEs are 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.”*

*“1.2 An entity has public accountability if:*

- (a) it files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or*
- (b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity.”*

### **Application of the scope of the Statement of GAAP for SMEs as determined by the APB**

The Preface to the Statement of GAAP for SMEs, in paragraph P13, .09 states *“Decisions on which entities are required or permitted to use the IASB’s standards rest with national regulatory authorities and standard-setters.”*

Accordingly, the APB has decided that the Statement of GAAP for .10 SMEs may be applied as follows:

- For companies: The Statement of GAAP for SMEs may be applied by 'limited interest companies', as defined in the Corporate Laws Amendment Act, 2006, if they do not have public accountability as defined in Section 1 of the Statement of GAAP for SMEs.
- For entities other than companies where legal provisions or other regulations require compliance with a specific financial reporting framework (other than Statements of GAAP): Such entities cannot apply the Statement of GAAP for SMEs even if they do not have public accountability as defined in Section 1 of the Statement of GAAP for SMEs.
- For entities other than companies whose financial reporting framework is not set out by legal provisions or other regulations: If such entities do not have public accountability, as defined in Section 1 of the Statement of GAAP for SMEs, they should assess whether it is appropriate to apply the Statement of GAAP for SMEs.

### **Effective date of the Statement of GAAP for SMEs**

- .11 'Limited interest companies' within the scope of the Statement of GAAP for SMEs, as described in paragraph 8, may only apply the Statement of GAAP for SMEs to annual financial statements for financial years ending on or subsequent to 31 December 2005 that are issued on or after 1 October 2007.
- .12 For entities other than companies whose financial reporting framework is not set out by legal provisions or other regulations, the Statement of GAAP for SMEs may be applied to annual financial statements that are issued on or after 1 October 2007.

### **Financial reporting frameworks for 'limited interest companies'**

- .13 A 'limited interest company' could continue to apply its existing reporting framework (which could be either South African Statements of GAAP or IFRS).
- .14 Alternatively, even before the Corporate Laws Amendment Act is effective, a company that will qualify as a 'limited interest company' in terms of the Corporate Laws Amendment Act may apply the Statement of GAAP for SMEs (assuming the scope requirements in Section 1 of

the Statement of GAAP for SMEs are met) and still be in compliance with the Companies Act, 1973. The reason for this is that the Statement of GAAP for SMEs forms part of 'Statements of GAAP as approved by the APB', as referred to in paragraph 5 of Schedule 4 of the Companies Act, 1973.

### **Development of the Statement of GAAP for SMEs**

Financial reporting frameworks applied by companies in South Africa .15 have been either South African Statements of GAAP or IFRS. Numerous preparers have expressed a need for simplified financial reporting frameworks for smaller companies. The Corporate Laws Amendment Act introduced a possibility of a different financial reporting framework for 'limited interest companies'.

It was noted that the IASB was developing a standard for SMEs and had .16 issued an exposure draft, *IFRS for SMEs*. This exposure draft proposes disclosure relief, simplification of many recognition and measurement criteria, removal of choices for accounting treatment, and elimination of topics that are generally not relevant to SMEs.

It is evident that the IASB is committed to taking cognisance of the .17 views of commentators around the world, many of whom have comments similar to those from South Africa. It is likely that the final international standard may provide further relief from the current exposure draft. It is also noteworthy that the *IFRS for SMEs* exposure draft does not propose a mandatory fallback to full IFRSs.

SAICA therefore recommended to the APB that it adopt the IASB's .18 proposed *IFRS for SMEs* in its exposure draft form, as a transitional standard for 'limited interest companies' in South Africa. This process was introduced in ED 225 – *Financial Reporting for Small and Medium-sized Entities (SMEs) – Proposed Process*, issued in May 2007.

The majority of respondents to ED 225 supported the proposed process. .19 Discussion forum sessions on *IFRS for SMEs* were held around the country and most participants also agreed with the process proposed in ED 225.

**Interaction with the IASB's final version of *IFRS for SMEs***

- .20 The IASB is still in the process of finalising *IFRS for SMEs*. Hence, in the IASB's exposure draft of *IFRS for SMEs*, reference is made to a "[draft] standard". Changes to the exposure draft on *IFRS for SMEs* are highly likely. When the IASB issues a final standard on *IFRS for SMEs*, the APB or its successor body will consider making corresponding amendments to the Statement of GAAP for SMEs.

**Corporate Laws Amendment Act and Schedule 4**

- .21 'Limited interest companies' preparing financial statements in accordance with the Statement of GAAP for SMEs should, over and above the disclosures required by the Statement of GAAP for SMEs, disclose everything required by Schedule 4 of the Companies Act, 1973.

**Requirement to prepare consolidated financial statements**

- .22 Section 290 of the Corporate Laws Amendment Act does not require a 'limited interest company' to prepare consolidated financial statements if the directors of the company are of the opinion that the required information about the state of affairs, business, and profit or loss of the company and its subsidiaries would be presented more effectively and meaningfully in an alternative form of group annual financial statements as contemplated in section 290 of the Corporate Laws Amendment Act.
- .23 Paragraph 9.1 of the Statement of GAAP for SMEs requires a parent company to prepare consolidated financial statements in which it must include all its subsidiaries.
- .24 Paragraph 9.2 of the Statement of GAAP for SMEs provides an exemption to the requirement to prepare consolidated financial statements if:
- “(a) *The parent is itself a subsidiary; and*
- (b) *Its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with full International Financial Reporting Standards or with this [draft] standard.*”
- .25 The exemption will also apply if the ultimate or intermediate parent produces consolidated financial statements that comply with Statements of GAAP or the Statement of GAAP for SMEs.

Except where the criteria in paragraph 9.2 of the Statement of GAAP .26 for SMEs are met, the preparation of consolidated financial statements will be required. Where a 'limited interest company' does not prepare consolidated financial statements when required to do so by the Statement of GAAP for SMEs, this will result in non-compliance with the Statement of GAAP for SMEs. Non-consolidation will therefore result in a modified audit opinion.

### **Audit reporting considerations**

The Independent Regulatory Board for Auditors (IRBA) considered the .27 reasons for SAICA's proposal to the APB to adopt the IASB's proposed *IFRS for SMEs* in its exposure draft form and concluded that *IFRS for SMEs* in its exposure draft form, without amendment, would constitute an acceptable financial reporting framework for entities within the scope of the Statement of GAAP for SMEs, as determined by the APB. The IRBA also concluded that the Statement of GAAP for SMEs would be a "fair presentation framework".

Consequently, an auditor can express an opinion that financial .28 statements are "presented fairly", in all material respects, in accordance with the Statement of GAAP for SMEs.

When an auditor issues an audit report on an entity applying the .29 Statement of GAAP for SMEs, the audit report should identify the accounting framework as the 'Statement of Generally Accepted Accounting Practice for Small and Medium-sized Entities'. The audit report may not make reference to 'International Financial Reporting Standards for Small and Medium-sized Entities'.

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**I Sehoole  
Executive President**