

Statement of Generally Accepted Accounting Practice (GAAP): International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)

Introduction

- .01 On 7 August 2007 the Accounting Practices Board (APB) approved the 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). On 9 July 2009 the IASB issued the IFRS for SMEs. On 13 August 2009 the Accounting Practices Board approved the issue of the Statement of GAAP: IFRS for SMEs (IFRS for SMEs) and withdrew the Statement of GAAP for SMEs for financial periods ending after 31 August 2010.
- .02 Following the approval of the IFRS for SMEs in August 2009, which resulted in the withdrawal of the Statement of GAAP for SMEs, some companies have not yet adopted IFRS for SMEs. The reason for not moving to IFRS for SMEs is the provision in the Companies Act, 2008, for differential reporting standards that has not yet been finalised. To deal with the uncertainty relating to the Companies Act amendments and related regulations, the APB agreed in March 2011 to extend the withdrawal date of 31 August 2010 for the Statement of GAAP for SMEs to one year after the effective date of the Companies Act, 2008. Consequently, paragraph 16 of this Circular was also revised. Companies are nevertheless permitted to convert to IFRS for SMEs provided the scope paragraphs IFRS for SMEs and/or the Companies Act does not prevent this.
- .03 This circular addresses the following areas:
- Types and forms of companies in terms of the Companies Act, 1973
 - Classification of companies and financial reporting in terms of the Corporate Laws Amendment Act, 2006;

- Classifications of companies and financial reporting in terms of the Companies Act, 2008;
- The scope of the IFRS for SMEs;
- Application of the scope of the IFRS for SMEs by the APB;
- Effective date of the IFRS for SMEs;
- Entities reporting in terms of the Statement of GAAP for SMEs;
- Requirement to prepare consolidated financial statements;
- Audit reporting considerations; and
- Transitional arrangements.

Types and forms of companies in terms of the Companies Act, 1973

.04 Two types of companies may be formed and incorporated under this Act, namely:

- “(a) a company having a share capital; or*
- (b) a company not having a share capital and having the liability of its members limited by the memorandum of association (in this Act termed "a company limited by guarantee").*

A company having a share capital may be either a public company or a private company having shares of par value or shares of no par value.

All companies limited by guarantee, including such existing companies, shall be deemed to be public companies for the purposes of this Act.”

.05 In this Act the expression "private company" means “a company having a share capital and which by its articles -

- (a) restricts the right to transfer its shares; and*
- (b) limits the number of its members (exclusive of persons who are in the employment of the company and of persons who having been formerly in the employment of the company were, while in such employment, and have continued after the termination of such employment to be, members of the company) to fifty; and*
- (c) prohibits any offer to the public for the subscription of any shares or debentures of the company.”*

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

.06 The Corporate Laws Amendment Act was signed into law on 17 April 2007 and became effective on 14 December 2007. The Corporate Laws

Amendment Act retained the public and private company classifications, but further classified companies either as ‘widely held’ or ‘limited interest’, as follows:

“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).*

A company with two or more types of classes or 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.

A company is a limited interest company if it is not a widely held company.”

.07 The Corporate Laws Amendment Act introduced a new section dealing with Financial Reporting Standards and the Financial Reporting Council. In terms of Section 440S:

“The Council shall:

- (a) establish financial reporting standards for public interest companies; and*
- (b) develop accounting standards for limited interest companies”.*

.08 Financial reporting standards are defined in Section 1 as:

“Statements of Generally Accepted Accounting Practice adopted by the Accounting Practices Board prior to the establishment of the Council”

Classification of companies and financial reporting in terms of the Companies Act, 2008

.09 The Companies Act, 2008 was signed into law on 19 April 2009. At the date of issue of this Circular, the Act had not been given an effective date.

.10 The Act specifies two categories of companies as follows:

- “8. (1) Two types of companies may be formed and incorporated under this Act, namely profit companies and non-profit companies.*
- (2) A profit company is –*

- (a) a state-owned company; or
- (b) a private company if –
 - (i) it is not a state-owned company; and
 - (ii) its Memorandum of Incorporation –
 - (aa) prohibits it from offering any of its securities to the public; and
 - (bb) restricts the transferability of its securities;
- (c) a personal liability company if -
 - (i) it meets the criteria for a private company; and
 - (ii) its Memorandum of Incorporation states that it is a personal liability company; or
- (d) a public company, in any other case.”

.11 The Act provides for regulation of financial reporting standards. In terms of Section 29(5) any such regulations:

- “(a) must promote sound and consistent accounting practices;
- (b) in the case of financial reporting standards, must be consistent with the International Financial Reporting Standards of the International Accounting Standards Board or its successor body; and
- (c) may establish different standards applicable to -
 - (i) profit and non-profit companies; and
 - (ii) different categories of profit companies”.

The scope of the IFRS for SMEs

.12 The preface to the IFRS for SMEs states:

“P13 Decisions on which entities are required or permitted to use the IASB’s standards rest with legislative and regulatory authorities and standard-setters in individual jurisdictions. This is true for **full IFRSs** and for the IFRS for Small and Medium-sized Entities. However, a clear definition of the class of entity for which the IFRS for Small and Medium-sized Entities is intended – as set out in Section 1 of the Standard – is essential so that (a) the IASB can decide on the accounting and disclosure requirements that are appropriate for that class of entity and (b) the legislative and regulatory authorities, standard-setters, and reporting entities and their auditors will be informed of the intended scope of applicability of the IFRS for Small and Medium-sized Entities. A clear definition is also essential so that entities that are not small or medium-sized entities, and therefore are not eligible to use the Standard, do not

assert that they are in compliance with the IFRS for Small and Medium-Sized Entities (see paragraph 1.5).”

.13 Section 1 of the IFRS for SMEs states:

“Intended scope of this IFRS

1.1 The IFRS for Small and Medium-sized Entities is intended for use by small and medium-sized entities (SMEs). This section describes the characteristics of SMEs.

Description of small and medium-sized entities

1.2 Small and medium-sized entities 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.*

1.3 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 (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.*

1.4 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. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organizations, co-operative enterprises requiring a nominal membership deposit, and sellers that receive payment in advance of delivery of the goods or services such as utility companies), they are not considered to be publicly accountable.

1.5 If a publicly accountable entity uses this IFRS, its financial statements shall not be described as conforming to the IFRS for

Small and Medium-sized Entities – even if law or regulation in its jurisdiction permits or requires this IFRS to be used by publicly accountable entities.

- 1.6 A **subsidiary** whose **parent** uses **full IFRSs**, or that is part of a consolidated **group** that uses full IFRSs, is not prohibited from using this IFRS in its own financial statements if that subsidiary by itself does not have public accountability. If its financial statements are described as conforming to the IFRS for Small and Medium-sized Entities, it must comply with all of the provisions of this IFRS.”

Application of the scope of the IFRS for SMEs by the APB

.14 Accordingly, the APB has decided that the IFRS for SMEs may be applied as follows:

- (a) For companies with financial year ends prior to the effective date of the Companies Act 2008:

The IFRS for SMEs may be applied by:

- a “public company” or a “private company”, as defined in the Companies Act, 1973, and
- a “limited interest company” or a “widely held company” as defined in the Corporate Laws Amendment Act, 2006

if it does not have public accountability as defined in Section 1 of the IFRS for SMEs.

- (b) For companies with financial year ends on or after the effective date of the Companies Act 2008:

The IFRS for SMEs may be applied by:

- a non-profit company;
- a private company;
- a personal liability company; and
- a public company

as defined in the Companies Act, 2008, if it does not have public accountability as defined in section 1 of the IFRS for SMEs.

- (c) For entities other than companies where the founding document or other regulation requires compliance with a “fair presentation framework” as contemplated by the International Federation of Accountants (“IFAC”):

The IFRS for SMEs may be applied, if the entity does not have public accountability as defined in section 1 of the IFRS for SMEs, except in the circumstances described in (d) below.

- (d) For entities where legal provisions or other regulations require compliance with a specific financial reporting framework (other than the IFRS for SMEs):

Such an entity may not apply the IFRS for SMEs even if it does not have public accountability as defined in Section 1 of the Statement of IFRS for SMEs.

- (e) For entities whose financial reporting framework is not set out by legal provisions, the founding statement or other regulations:

If such an entity does not have public accountability, as defined in Section 1 of the Statement of IFRS for SMEs, it should assess whether it is appropriate to apply the IFRS for SMEs.

Effective date of the IFRS for SMEs

- .15 An entity may apply IFRS for SMEs for annual financial statements that are authorised for issue after 13 August 2009.

Entities reporting in terms of the Statement of GAAP for SMEs

- .16 An entity may continue to apply the Statement of GAAP for SMEs for year ends up to and including one year after the effective date of the Companies Act, 2008.

Requirement to prepare consolidated financial statements

- .17 The requirement to present consolidated financial statements as set out in paragraphs 9.2 and 9.3 of the IFRS for SMEs is as follows:

*“9.2 Except as permitted by paragraph 9.3, a **parent** entity shall present consolidated financial statements in which it consolidates its investments in **subsidiaries** in accordance with this IFRS. Consolidated financial statements shall include all subsidiaries of the parent.*

9.3 A parent need not present consolidated financial statements if:

(a) both of the following conditions are met:

(i) the parent is itself a subsidiary; and

- (ii) *its ultimate parent (or any intermediate parent) produces consolidated **general purpose financial statements** that comply with full **International Financial Reporting Standards** or with this IFRS; or*
 - (b) *it has no subsidiaries other than one that was acquired with intention of selling or disposing of it within one year. In this case, the parent shall account for such a subsidiary:*
 - (i) *at fair value with changes in fair value recognised in profit or loss, if the fair value of the shares can be measured reliably, or*
 - (ii) *otherwise at cost less impairment (see paragraph 11.14)."*
- .18 The exemption in 9.3(a) will apply if the ultimate or intermediate parent produces consolidated financial statements that comply with IFRS, Statements of GAAP or the IFRS for SMEs.
- .19 Except where the criteria in paragraph 9.3 of the IFRS for SMEs are met, the preparation of consolidated financial statements will be required. Where an entity does not prepare consolidated financial statements when required to do so by the IFRS for SMEs, this will result in non-compliance with the IFRS for SMEs. Non-compliance with the IFRS for SMEs will result in a modified audit report when the effect on the financial statements is material.

Audit reporting considerations

- .20 A precondition for an audit is that management determines an acceptable financial reporting framework for the entity, and it is the auditor's responsibility to assess whether the framework applied is appropriate.
- .21 The IFRS for SMEs may constitute an acceptable financial reporting framework for entities within the scope of the IFRS for SMEs, as issued by the APB. It is also a "fair presentation framework".
- .22 Consequently, an auditor may express an opinion that financial statements are "presented fairly", in all material respects, in accordance with the IFRS for SMEs.
- .23 When an auditor issues an audit report on an entity applying the IFRS for SMEs, the audit report should identify the accounting framework as the

‘International Financial Reporting Standard for Small and Medium-sized Entities’.

Transitional arrangements

First time adoption of the IFRS for SMEs

.24 The IFRS for SMEs states that an entity is a first-time adopter of the standard when in its first financial statements the entity makes an explicit and unreserved statement of compliance with the IFRS for SMEs. This is the case regardless of whether its most recent financial statements were prepared under full IFRS or national requirements that are not consistent with the IFRS for SMEs in all respects.

.25 Accordingly, companies or other entities, currently using:

- IFRS,
- Statements of GAAP,
- the Statement of GAAP for SMEs, or
- an entity specific basis of accounting

will all be classified as first-time adopters of the IFRS for SMEs when they adopt that standard. The transition provisions of Section 35 of the IFRS for SMEs will apply.

**Johannesburg
March 2011**

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