

# Focus on: IFRS for SMEs Ireland

## Global market. Global players. Global numbers.

Privately held businesses across Ireland stand to benefit from a new financial reporting standard for SMEs.

Following publication by the International Accounting Standards Board in 2009, the Accounting Standards Board (ASB) is proposing to allow SMEs in Ireland and the United Kingdom (UK) replace current accounting standards and generally accepted accounting principles (GAAP) with international financial reporting standards for small and medium sized entities (IFRS for SMEs).

The move to IFRS for SMEs is expected to reduce the reporting burden allowing SMEs more time to focus on their core objectives.

While the implementation of the new standard will require an initial outlay of time and resources, there will be a significant long-term payoff for SMEs. Overall IFRS for SMEs is:

- **more comparable internationally**, which is a particular advantage for groups with overseas subsidiaries and businesses looking to acquire or raise capital
- **less onerous**, containing only a limited number of recognition and measurement requirement differences, and less extensive disclosures from full IFRS (about 300 potential disclosure items compared to 3,000 in full IFRS)
- **less complicated**, with one set of rules for all entities adopting it. It has also been specifically written for privately held businesses (PHBs) and
- **more stable**, with amendments made through one single revised standard every three years.

## Irish SMEs leading the way

The main findings of our International Business Report 2010 showed Irish businesses were leading the charge in terms of responding to the recession with:

- 75 per cent of businesses looking at new target markets (global ranking 1st)
- 66 per cent developing new products and services (global ranking 5th)
- 69 per cent focusing on the skills of the workforce (global ranking 6th).

When it comes to IFRS, Irish SMEs look to the new standard enthusiastically:

- Ireland ranked 1st globally with highest awareness of IFRS at 86 per cent (global 53 per cent, EU 67 per cent)
- Irish SMEs ranked 2nd in Europe with 77 per cent of Irish SMEs wishing the country to adopt IFRS for SMEs (global 52 per cent and EU 53 per cent).

In relation to the benefits SMEs expect from good financial reporting generally:

- 85 per cent of Irish SMEs expect its financial reporting to increase transparency and access to capital (global 52 per cent and 37 per cent, EU 47 per cent and 37 per cent respectively)
- one in two Irish SMEs expect financial reporting to facilitate cross border merger and acquisition and trading.

## Navigating the way

Over the course of the following pages we examine in more detail:

- what the new regulations mean
- what businesses are saying
- what changing to IFRS means for you
- what are the tax implications and
- how to plan for your business.

From our experience assisting our listed clients with the transition to IFRS, we believe thinking about the issues early can save time and reduce problems later.

## To change is to improve

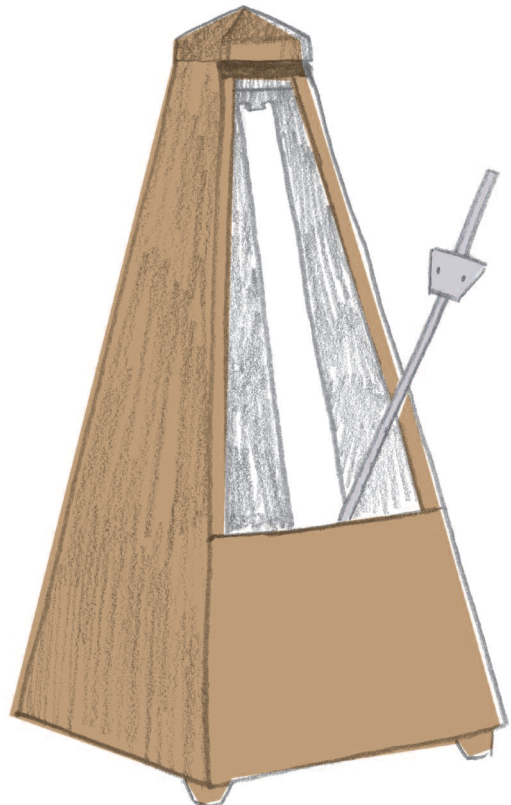
As is evident from the results of our International Business Report, Irish companies have expressed their awareness and willingness to adopt IFRS for SMEs.

Clearly Irish SMEs feel tarnished by the damaged reputation of Ireland Inc as the fallout from the Irish banking crisis continues. Irish SMEs see a “first mover” advantage in moving to globally approved standards.

Although the standard was issued in 2009 the ASB set an original expected implementation date of 1 January 2012. This has recently been extended by 12 months.

Given the overwhelming support of Irish SMEs for IFRS we would encourage a speedy adoption to increase Irish SMEs competitive advantage in a very difficult trading environment particularly as IFRS is expected to increase access to credit. 2013 is another world away for the progressive but struggling Irish SMEs.

Good practice is always good business.



# What the new regulations mean

## What is the IFRS for SMEs?

The IFRS for SMEs is a simplified version of the full IFRS, aimed at the needs of private companies.

Containing less than 300 potential disclosure items, compared to nearly 3,000 in the full IFRS, the IFRS for SMEs is a self-contained standard in which many of the principles for recognising and measuring assets, liabilities, income and expenses have been simplified. Topics not relevant to SMEs have been omitted, and the number of required disclosures has been significantly reduced.

Following its publication in 2009 by the International Accounting Standards Board, there is now, for the first time, an internationally recognised reporting framework for private companies intended to assist those involved in their financing, to assess performance and make decisions on a like-for-like basis.

## Who can use it?

The IFRS for SMEs is effective immediately on issue. It is, however, up to individual jurisdictions to decide which entities will be required or permitted to use the IFRS for SMEs – the Standard does not itself deal with this question.

The IFRS for SMEs will be particularly welcome in those countries that currently require full IFRS to be used for all entities, listed and unlisted, due to the reduced complexity of the Standard compared to full IFRS.

## What's the situation in Ireland?

The ASB has proposed replacing Irish and UK GAAP with a new 'tier system' based on public accountability, and incorporating the IFRS for SMEs (see figure 1).

Figure 1: ASB tier approach

ASB tier	Type of entity	GAAP options
Tier 1	Publicly accountable; EU listed; AIM; IEX	IFRS
Tier 2	Large or medium non-publicly accountable entities or groups	IFRS for SMEs or choose full IFRS
Tier 3	Small	FRSSE or choose IFRS for SMEs or full IFRS

As it is not linked to size, the IFRS for SMEs would apply to large private companies as well as small and medium-sized companies.

The ASB previously issued a consultation paper in August 2009 with a proposed adoption commencement date of years beginning on or after 1 January 2012. Subsequent responses to this consultation paper resulted in a postponement of the proposed adoption date for the IFRS for SMEs. The ASB are now working to an effective date of accounting periods beginning on 1 January 2013, 12 months later than the original proposal.

The EU has not yet approved IFRS for SMEs in individual member states and is currently working through the accounting directives to enable the transition. This process is expected to be completed within 12 months.



# What businesses are saying

The Grant Thornton International Business Report (IBR)<sup>1</sup> traces issues affecting PHBs globally for the last 18 years. This year's survey brings together the opinions of over 7,400 respondents in 36 economies and the graphs in this section outline Ireland's view in relation to IFRS for SMEs compared to these other economies under three separate headings: IFRS awareness; IFRS adoption and financial reporting benefits.

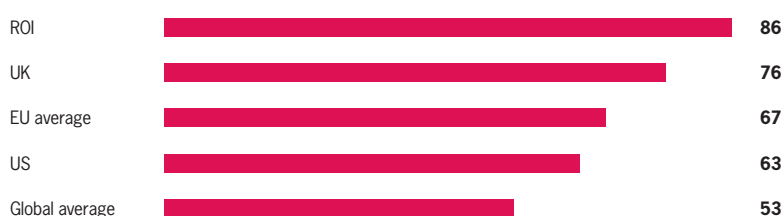
The results of this survey illustrate the awareness and willingness of Irish companies to lead with this new reporting standard, enabling international comparability, and view good financial reporting as a way of reducing cost and complexity.

## IFRS awareness

- the majority of business owners in Ireland are aware of IFRS for SMEs (86 per cent)
- global average of awareness is 53 per cent, with the EU and UK higher at 67 per cent and 76 per cent respectively
- the US is slightly above the global average at 63 per cent.

**Figure 2: Have you heard of the IFRS for SMEs?**

Percentage of businesses



Source: Grant Thornton IBR 2010

<sup>1</sup> the Grant Thornton International Business Report (IBR) is an annual survey of the views of senior executives in privately held businesses all over the world. Launched in 1992 in nine European countries the report now surveys over 7,400 PHBs in 36 economies. To find out more about IBR and to obtain copies of reports and summaries visit: [www.internationalbusinessreport.com](http://www.internationalbusinessreport.com)

### IFRS adoption

- of those Irish SMEs that have heard of IFRS for SMEs, three-quarters (77 per cent) would like their country to adopt it
- this compares to a global average of 52 per cent with the UK and EU at 52 per cent and 53 per cent respectively
- the US lags behind at 41 per cent.

**Figure 3: Would you like your country to adopt IFRS for SMEs?**

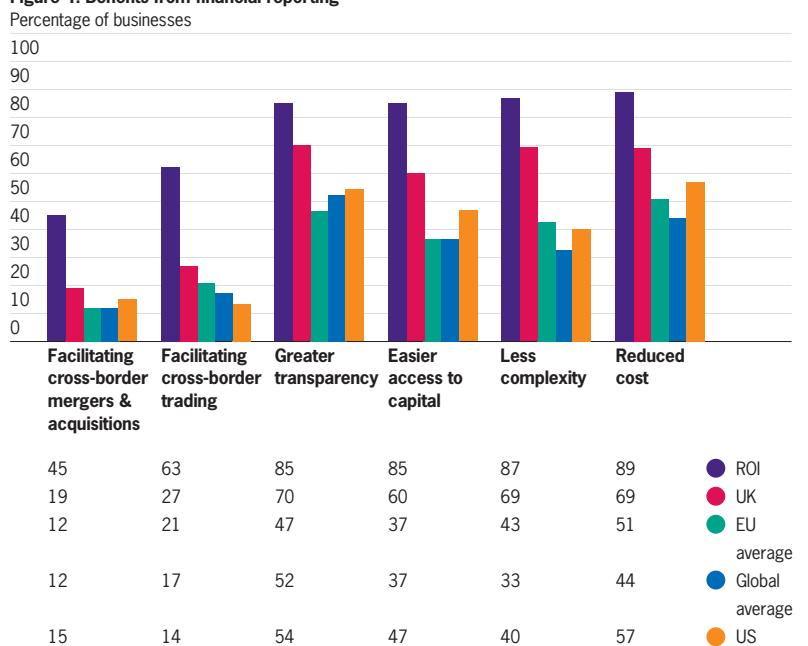


Source: Grant Thornton IBR 2010

### Financial reporting benefits

- reduced cost is the most popular expected benefit of financial reporting in Ireland (89 per cent), the global average is 44 per cent, while the EU average is at 51 per cent and the UK is at 69 per cent
- less complexity (87 per cent), easier access to capital and greater transparency (both 85 per cent) are also popular benefits, with more than four-fifths of business owners
- facilitating cross-border mergers and acquisitions was the least popular, even though it was cited by 45 per cent
- Irish SMEs consistently see significantly greater benefits than other countries.

**Figure 4: Benefits from financial reporting**



# What they mean for you

## Which GAAP will need to be adopted?

Figure 5: ASB tier approach

ASB tier	Type of entity	GAAP options
<b>Tier 1</b>	Publicly accountable; EU listed; AIM; IEX	IFRS
<b>Tier 2</b>	Large or medium non-publicly accountable entities or groups	IFRS for SMEs or choose full IFRS
<b>Tier 3</b>	Small	FRSSE or choose IFRS for SMEs or full IFRS

- publicly accountable entities in tier 1 will be required to adopt full IFRS
- small companies within the definition of the Companies (Amendment) Act 1986 for Irish companies, and Companies Act 2006 for UK companies, will make up tier 3 and will be able to use the financial reporting standards for smaller entities (FRSSE), IFRS for SME's or full IFRS
- companies which are neither publicly accountable nor small would have to adopt the IFRS for SMEs, or full IFRS. This would include many private companies in Ireland and the UK. Any company could adopt the GAAP of a higher tier.

## What is a 'publicly accountable' entity?

The precise definition of 'publicly accountable' to be applied to Irish and UK entities is yet to be decided. The proposed definition would include companies with debt or equity instruments traded in domestic or foreign public markets and companies in the process of issuing such instruments. It would also include companies that take deposits and/or hold assets in a fiduciary capacity as one of their primary businesses.



Figure 6 sets out a summary of the main areas of difference between ROI/UK GAAP and IFRS for SMEs.

Figure 6: IFRS for SMEs and Irish/UK GAAP – the key differences

Area of difference	Irish/UK GAAP	IFRS for SMEs
<b>Cash flow statement</b>	Exemption for 90 per cent subsidiaries and small companies.	No exemptions for small companies or subsidiaries. All financial statements require a cash flow statement.
<b>Acquisitions</b>	Acquisition accounting, or merger accounting where the conditions are met.	Use purchase method (essentially acquisition accounting). No exemption for small groups from preparing group accounts.
<b>Financial instruments</b>	Initial recognition is usually at transaction value. Loans and shares classified as liabilities with non-standard terms are measured at amortised cost. Derivatives are not recognised on the balance sheet, but are disclosed.	Financial instruments are classified as ‘basic’ or ‘other’. Initial recognition is at fair value. Loans and shares classified as liabilities with non-standard terms measured at fair value. Derivatives are recognised on the balance sheet at fair value.
<b>Property, plant and equipment/tangible fixed assets</b>	Measured at cost less depreciation or revalued amount.	No option to revalue – measure at cost less depreciation.
<b>Deferred tax</b>	Timing difference approach.	Temporary difference approach – deferred tax will be provided on all accounting revaluations if there is no revaluation for tax purposes. Deferred tax may also be recognised on some permanent differences.
<b>Useful life of intangible assets and goodwill</b>	Option to have an indefinite useful life, with annual impairment reviews.	No indefinite useful life permitted – if a useful life cannot be estimated reliably, ten years should be used.
<b>Development costs</b>	Option to capitalise where the criteria are met.	Must be expensed in the period in which they are incurred.
<b>Foreign currency translation</b>	Option to use forward contract rate where criteria are met.* Movements in foreign equity investments can be hedged using foreign currency borrowings.* Accounts are presented in functional currency.*	No use of forward contract rate (recognise foreign exchange forward contracts as financial instruments). No option to use foreign currency borrowings as a hedging instrument. Option to translate into a different presentation currency.
<b>Investment property</b>	Revalued to open market value, with movements recognised through the statement of total recognised gains and losses.	Measure at fair value, with movements recognised through profit or loss for the year.
<b>Borrowing costs/ interest costs</b>	Option to capitalise where criteria are met.	All borrowing costs must be expensed as incurred.
<b>Defined benefit investment schemes</b>	Valued based on the projected unit credit method, with a full actuarial valuation every three years.	Simplifications permitted to be made to the projected unit credit method, with no requirement for an independent actuary.
<b>Classification of leases</b>	Based on transfer of substantially all risks and rewards of ownership. If present value of minimum lease payments is 90 per cent or more of their fair value, normally classify as finance lease.	Based on transfer of substantially all of the risks and rewards of ownerships. Assessment made against qualitative criteria.
<b>Agriculture</b>	No guidance.	Measure biological assets at fair value if readily determinable, otherwise cost.

\*only where FRS 26 is not applied

# What are the tax implications

## Will it impact on the tax charge?

The short answer is, it depends. The starting point for the calculation of the tax liability will continue to be the profit as per the financial statements. Thus, to the extent that the profit under IFRS for SMEs differs to Irish GAAP, this will impact on the current tax charge (see figure 7). As is the case under existing Irish GAAP, adjustments in the tax computation will be required where the tax treatment differs from the accounting treatment.

There are also provisions to ensure that any transitional adjustments on the move from Irish GAAP to IFRS to SMEs are spread evenly over a five year period. These provisions were introduced to cater for the transition to full IFRS but it is expected that they will apply equally to the transition to IFRS for SMEs.

Other differences in IFRS for SMEs will likely increase the work involved both in calculating deferred tax balances and in determining appropriate provisions in respect of uncertain tax positions.

Grant Thornton's recommendation is that entities consider the implications of the transition to IFRS for SMEs in advance of the change. This will avoid any unexpected cash/tax volatility and also help ensure that appropriate tax planning strategies can be put in place.



The following table sets out some of the key tax implications arising from the proposed move to IFRS for SMEs. This list is by no means exhaustive but gives a flavour of the anticipated tax issues.

Figure 7: Impact on tax of key accounting changes

Area	Current tax impact if IFRS for SMEs is adopted (compared with existing Irish GAAP)	Impact on deferred tax and effective tax rate if IFRS for SMEs is adopted (compared with existing Irish GAAP)
<b>Intangibles</b>	Expensing internal costs should result in a revenue deduction for development costs that may previously have been disallowed. Tax relief for expenditure on specified intangible assets may improve if assets are amortised over shorter period.	There should be no impact on the effective tax rate where deferred tax was provided under Irish GAAP. No deferred tax implications where accounting and tax amortisation equate. Deferred tax may arise where intangibles are written off over 15 years for tax purposes but accounting amortisation differs.
<b>Property, plant and equipment</b>	No impact.	No revaluations allowed, which will result in less complex deferred tax calculations.
<b>Investment property</b>	No effect as investment properties will only be taxed when sold.	Deferred tax should be computed on all temporary differences to include revaluations.
<b>Income tax</b>	No impact.	The temporary difference approach may result in additional deferred tax. The rules relating to provisions for tax uncertainties could result in a greater compliance burden in the accounting process.
<b>Defined benefit pension</b>	No effect as tax deductions continue to be based on actual payments.	No impact.
<b>Borrowing costs</b>	Generally no impact. However, there can be an adverse impact where interest capitalised under Irish GAAP formed part of the base cost of an investment property for capital gains tax (CGT) purposes. As the capitalisation option no longer exists, the interest will not be allowed for tax purposes (other than against any rental income that may arise from the property).	No deferred tax liability.
<b>Financial instruments</b>	Amounts included in profit & loss (P&L) statement will generally be taxable or deductible. Transitional rules should be considered if a taxable restatement arises in the year of transition. There are anti-avoidance provisions where "bed and breakfast" transactions take place.	The effective tax rate may be more volatile if resulting deferred tax assets are not recognised.

# How to plan for your business

## When will it affect your business?



### Key areas affected

- **distributable profits** – different recognition criteria may impact net profits which subsequently will impact profits available for distribution
- **staff training** – sufficient expertise and finance team training
- **loan covenants** – ratios may be impacted by the different recognition criteria to be applied
- **remuneration** – if management compensation, including incentives, is based on net profit or other financial metrics, then the amount payable could change
- **reporting systems** – chart of accounts and reporting deliverables may need to be revised.

### Benefits

- improved access to capital
- improved quality and comparability of reporting
- facilitates cross-border trading
- focused on the needs of users of SME financial statements
- audit efficiencies
- stability – initial two-year comprehensive review followed by three-yearly omnibus updates
- eases burden where full IFRS has previously been required
- stepping stone to full IFRS for private entities aiming for an initial public offering (IPO).

### Challenges

- learning new terminology and accounting techniques
- making changes to information systems and accounting software may be needed
- collecting additional data for some transactions
- dealing with new concepts
- dealing with valuation issues.



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