2009

IASC Foundation: Training Material for the IFRS® for SMEs

# Module 1 – Small and Medium-sized Entities

IASC Foundation Education®

# IASC Foundation: Training Material for the IFRS® for SMEs

including the full text of
Section 1 *Small and Medium-sized Entities*
of the International Financial Reporting Standard (IFRS)
for Small and Medium-sized Entities (SMEs)
issued by the International Accounting Standards Board on 9 July 2009

*with extensive explanations, self-assessment questions and case study*

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# Contents

# Module 1 – Small and Medium-sized Entities

This training material has been prepared by IASC Foundation education staff and has not been approved by the International Accounting Standards Board (IASB).
The accounting requirements applicable to small and medium-sized entities (SMEs) are set out in the *International Financial Reporting Standard (IFRS) for SMEs*, which was issued by the IASB in July 2009.

## INTRODUCTION

In July 2009 the International Accounting Standards Board (IASB) published the *International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs)*. The *IFRS for SMEs* is intended to apply to the general purpose financial statements of entities that do not have public accountability. Entities that have public accountability, and therefore are outside the scope of the *IFRS for SMEs*, include those whose shares or debt instruments are traded in a public market, banks, credit unions, securities brokers/dealers, mutual funds and insurance companies. In many countries entities that do not have public accountability are referred to by a variety of terms, including private entities and non-publicly accountable entities.

*Why a global financial reporting standard for SMEs?*

Global financial reporting standards, applied consistently, enhance the comparability of financial information. Accounting differences can obscure the comparisons that investors, lenders and others make. By requiring the presentation of useful financial information (ie information that is relevant, reliable, comparable etc), high quality global financial reporting standards improve the efficiency of the allocation and pricing of capital. This benefits not only those who provide debt or equity capital; it also benefits those entities that seek capital because it reduces their compliance costs and removes uncertainties that affect their cost of capital. Global standards also improve consistency in audit quality and facilitate education and training.

The benefits of global financial reporting standards are not limited to entities whose securities are traded in public capital markets. In the IASB's judgement, SMEs—and those who use their financial statements—can benefit from a common set of accounting standards. SMEs' financial statements that are comparable from one country to the next are needed for the following reasons:

- Financial institutions make loans across borders and operate multinationally. In most jurisdictions, over half of all SMEs, including the very small ones, have bank loans. Bankers rely on financial statements in making lending decisions and in establishing terms and interest rates.
- Vendors want to evaluate the financial health of buyers in other countries before they sell goods or services on credit.
- Credit rating agencies try to develop ratings uniformly across borders. Banks and other institutions that operate across borders often develop similar ratings. Reported financial information is crucial to the rating process.
- Many SMEs have overseas suppliers and use a supplier's financial statements to assess the prospects of a viable long-term business relationship.

- Venture capital firms provide funding to SMEs across borders.
- Many SMEs have outside investors who are not involved in the day-to-day management of the entity.

*The title of the standard—*IFRS for SMEs

The term 'SMEs' is widely recognised and used around the world, although many jurisdictions have developed their own definitions of the term for a broad range of purposes including prescribing financial reporting obligations. Often those national or regional definitions include quantitative criteria based on revenue, assets, employees or other factors. Frequently, the term is used to mean or to include very small entities without regard to whether they publish general purpose financial statements for external users.

The IASB considered whether to use another term. Even before publishing the exposure draft in February 2007, the IASB had used the term 'non-publicly accountable entity' (NPAE) for several months during 2005. During its redeliberations of the proposals in the exposure draft during 2008, the IASB also used both 'NPAEs' and 'private entities' for several months. Because the IASB concluded that full IFRSs are necessary for entities with public accountability, the terms 'publicly accountable entity' and 'non-publicly accountable entity' had some appeal. However, constituents argued that this term is not widely recognised, whereas 'small and medium-sized entities' and the acronym 'SMEs' are universally recognised. Also, some said that 'non-publicly accountable entities' seemed to imply, incorrectly, that the smaller entities were not publicly accountable for anything. Furthermore, the objectives of the IASC Foundation and the IASB as set out in the Foundation's Constitution use the term 'small and medium-sized entities'.

The term 'private entities' is commonly used in some jurisdictions—most particularly in North America—to refer to the kinds of entities that meet the IASB's definition of SMEs (entities without public accountability). In other jurisdictions, however—most particularly those in which government ownership of equity interests in business entities is common—the term 'private entities' is used much more restrictively to refer only to those entities in which there is no government ownership. In such jurisdictions, the term 'private entities' would be likely to be misunderstood.

For these reasons, the IASB decided to use 'small and medium-sized entities'.

*Different users' needs and cost-benefit considerations*

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

In establishing standards for the form and content of general purpose financial statements, the needs of users of financial statements are paramount.

The main groups of external users of SMEs financial statements include:

- banks that make loans to SMEs.
- vendors that sell to SMEs and use SMEs' financial statements to make credit and pricing decisions.

- credit rating agencies and others that use SMEs' financial statements to rate SMEs.
- customers of SMEs that use SMEs' financial statements to decide whether to do business.
- SMEs' shareholders that are not also managers of their SMEs.

Users of financial statements of SMEs may have less interest in some information in general purpose financial statements prepared in accordance with full IFRSs than users of financial statements of entities whose securities are registered for trading in public securities markets or that otherwise have public accountability. For example, users of financial statements of SMEs may have greater interest in short-term cash flows, liquidity, balance sheet strength and interest coverage, and in the historical trends of profit or loss and interest coverage, than they do in information that is intended to assist in making forecasts of an entity's long-term cash flows, profit or loss, and value. However, users of financial statements of SMEs may need some information that is not ordinarily presented in the financial statements of listed entities. For example, as an alternative to the public capital markets, SMEs often obtain capital from shareholders, directors and suppliers, and shareholders and directors often pledge personal assets so that the SMEs can obtain bank financing.

The nature and degree of the differences between full IFRSs and an *IFRS for SMEs* is determined on the basis of users' needs and cost-benefit analyses. In practice, the benefits of applying accounting standards differ across reporting entities, depending primarily on the nature, number and information needs of the users of their financial statements. The related costs may not differ significantly. Therefore, the IASB concluded that the cost-benefit trade-off should be assessed in relation to the information needs of the users of an entity's financial statements.

*This module*

This module focuses on the scope of the *IFRS for SMEs*. In the IFRS, Section 1 *Small and Medium-sized Entities* describes the characteristics of the entities for which the *IFRS for SMEs* is intended. This module introduces the learner to the *IFRS for SMEs*, guides the learner through the definition of SMEs, develops the learner's understanding of the requirements through the use of examples and indicates significant judgements that are required in determining whether an entity is publicly accountable. Furthermore, the module includes questions designed to test the learner's knowledge of the requirements and a case study to develop the learner's ability to determine whether an entity is publicly accountable and therefore cannot assert compliance with the *IFRS for SMEs*.

## Learning objectives

Upon successful completion of this module you should know the characteristics of SMEs as defined by the IASB in the *IFRS for SMEs*. You should also know which entities must not assert compliance with the *IFRS for SMEs*. Furthermore, through the completion of the case study that simulate aspects of the real world application of that knowledge, you should have enhanced your ability to determine which entities are SMEs as defined by the *IFRS for SMEs*.

### *IFRS for SMEs*

The *IFRS for SMEs* includes mandatory requirements and other material (non-mandatory) that is published with it.

The material that is not mandatory includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* and explains its purpose, structure and authority.
- implementation guidance, which includes illustrative financial statements and a disclosure checklist.
- the Basis for Conclusions, which summarises the IASB's main considerations in reaching its conclusions in the *IFRS for SMEs*.
- the dissenting opinion of an IASB member who did not agree with the publication of the *IFRS for SMEs*.

In the *IFRS for SMEs* the Glossary is part of the mandatory requirements.

In the *IFRS for SMEs* there are appendices in Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* Those appendices are non-mandatory guidance.

### Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows 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. The objective of Section 1 *Small and Medium-sized Entities* is to describe the characteristics of small and medium-sized entities for which the *IFRS for SMEs* is intended.

# Module 1 – Small and Medium-sized Entities

## REQUIREMENTS AND EXAMPLES

The contents of Section 1 *Small and Medium-Sized Entities* of the *IFRS for SMEs* are set out below and shaded grey. Terms defined in the Glossary of the *IFRS for SMEs* are also part of the requirements. They are in **bold type** the first time they appear in the text of Section 1. The notes and examples inserted by the IASC Foundation education staff are not shaded. Other annotations inserted by the IASC Foundation staff are presented within square brackets in ***bold italics***. The insertions made by the staff do not form part of the *IFRS for SMEs* and have not been approved by the IASB.

## Intended scope of this IFRS

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

### Notes

*Can I use the* IFRS for SMEs*?*

Decisions on which entities are required or permitted to use the *IFRS for SMEs* rest with legislative and regulatory authorities and standard-setters in individual jurisdictions (paragraph 13 of the preface to the *IFRS for SMEs*). However, a clear definition of the class of entity for which the *IFRS for SMEs* is intended is essential so that 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 SMEs* and so that entities that are not small or medium-sized entities, and therefore are not eligible to use the *IFRS for SMEs*, do not assert that they are in compliance with it (see paragraph 1.5).

The term 'small and medium-sized entities' as used by the IASB is defined in the Glossary and is explained in paragraphs 1.2–1.6 below. The key elements of the IASB's definition of SMEs are that they do not have public accountability (see paragraph 1.3) and that they publish general purpose financial statements (as defined in the Glossary).

Many jurisdictions have developed their own definitions of SMEs for a broad range of purposes including prescribing financial reporting obligations. Unlike the IASB's definition of SMEs, those national or regional definitions often include quantified criteria based on revenue, assets, employees or other factors. Others use the term SMEs 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 government agencies. Financial statements produced solely for those purposes are not necessarily general purpose financial statements.

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.

*Can I use the* IFRS for SMEs *for periods before 9 July 2009?*

The IASB issued the *IFRS for SMEs* on 9 July 2009. The Board did not specify a date from which the *IFRS for SMEs* is effective. Nothing in the *IFRS for SMEs* prevents an entity that does not have public accountability from preparing its financial statements for a period ending before 9 July 2009 in accordance with the *IFRS for SMEs*. However, decisions on when specified entities are required or permitted to use the *IFRS for SMEs* rest with legislative and regulatory authorities and standard-setters in individual jurisdictions.

*Quantified size criteria?*

The IASB's definition of SMEs does not include quantified size criteria for determining what is a small or medium-sized entity because it is not feasible to develop quantified size tests that would be applicable and long-lasting in numerous countries.

In deciding which entities should be required or permitted to use the *IFRS for SMEs*, jurisdictions may choose to prescribe quantified size criteria. Similarly, a jurisdiction may decide that entities that are economically significant in that country should be required to use full IFRSs rather than the *IFRS for 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 *[Refer: paragraph 1.3]*

(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.

### Notes

*General purpose financial statements*

The objective of general purpose financial statements prepared in accordance with the *IFRS for SMEs* is to provide useful information about an entity's financial position, performance and cash flows to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs. Accordingly, general purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors and employees.

The *IFRS for SMEs* is designed to apply to the general purpose financial statements and other financial reporting of those profit-oriented entities that do not have public accountability (see paragraph 1.3).

General purpose financial statements include those that are presented separately or within another public document such as an annual report.

SMEs often produce financial statements only for a specific purpose—the use of owner-managers, or for tax reporting or other non-securities regulatory filing purposes. Financial statements produced solely for those purposes are not necessarily general purpose financial statements.

Tax authorities are often important external users of the financial statements of SMEs. Almost invariably, tax authorities have the power to demand whatever information they need to meet their statutory tax assessment and collection obligations. Tax authorities often look to financial statements as the starting point for determining taxable profit, and some have policies to minimise the adjustments to accounting profit or loss for the purpose of determining taxable profit. Nonetheless, global accounting standards for SMEs cannot deal with tax reporting in individual jurisdictions. But profit or loss determined in conformity with the *IFRS for SMEs* can serve as the starting point for determining taxable profit in a given jurisdiction by means of a reconciliation that is easily developed at a national level.

A similar reconciliation can be developed to adjust profit or loss as measured by the *IFRS for SMEs* to distributable income under national laws or regulations.

Owner-managers use SMEs' financial statements for many purposes. However, it is not the purpose of the *IFRS for SMEs* to provide information to owner-managers to help them make management decisions. Managers can obtain whatever information they need to run their business. Nonetheless, general purpose financial statements will often also serve managers' needs by providing insights into the business's financial position, performance and cash flows.

### Examples – general purpose financial statements

Ex 1 **An entity that does not have public accountability voluntarily (ie it is not required to do so) prepares its financial statements in compliance with the requirements of the *IFRS for SMEs*. The entity sends the financial statements to the entity's primary suppliers, bankers and non-manager owners. The entity makes an explicit and unreserved statement of compliance with the *IFRS for SMEs* in the notes.**

The entity's financial statements are general purpose financial statements—the financial statements are prepared on a basis (the *IFRS for SMEs*) that is designed to provide useful information to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs.

Ex 2 **The facts are the same as in example 1. However, in this example, the financial statements are not sent to anyone outside the management of the organisation.**

The entity's financial statements are general purpose financial statements—the financial statements are prepared on a basis (the *IFRS for SMEs*) that is designed to provide useful information to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs.

Note: The fact that the general purpose financial information is not accessible to anyone outside the entity is irrelevant to the determination of whether the financial statements are for a general purpose. It is the design of the basis on which the financial statements are prepared that is the determining factor (ie are the requirements of the basis of preparation directed to the general information needs of a wide range of users who are not in a position to demand reports tailored to meet their information needs?).

Ex 3 **An entity that does not have public accountability prepares its financial statements following the local GAAP of the jurisdiction in which it operates. The local GAAP is, except in name, word-for-word the same as the *IFRS for SMEs*. The entity sends the financial statements to the entity's primary suppliers, bankers and tax authorities. The entity makes an explicit and unreserved statement of compliance with local GAAP in the notes.**

The entity's financial statements are general purpose financial statements—the financial statements are prepared on a basis (local GAAP that is word-for-word the same the same as *IFRS for SMEs*) that is designed to provide useful information to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs.

### Examples – not necessarily general purpose financial statements

Ex 4 **An entity that does not have public accountability prepares financial statements in compliance with the tax requirements for calculating taxable income (and tax expenses) in the jurisdiction in which it operates. The jurisdiction's tax requirements are different from the requirements of the *IFRS for SMEs*. The entity sends the financial statements only to the tax authorities. The entity makes an explicit and unreserved statement of compliance with local tax requirements in the notes.**

The entity's financial statements are special purpose financial statements—they are produced specifically for tax reporting (ie tax accounts). The requirements of tax accounts are determined by fiscal considerations and are unlikely to be designed to provide useful information to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs. Accordingly, the tax accounts are unlikely to be general purpose financial statements.

Ex 5 **The facts are the same as in example 4. However, in this example, the entity also sends the financial statements to the entity's bankers and the national repository (a legal requirement of the jurisdiction in which the entity operates). A copy of all financial statements lodged with the national repository can be downloaded by anyone free of charge from the national repository's website.**

The entity's financial statements are special purpose financial statements—they are produced on a basis designed for tax reporting (ie tax accounts). The requirements of tax accounts are determined by fiscal considerations and are unlikely to be designed to provide useful information to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs. Accordingly, even though the tax accounts are available to anyone that would like access to them, they are unlikely to be general purpose financial statements.

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.

## Notes

*Securities are traded in a public market*

Public securities markets, by their nature, bring together entities that seek capital and investors who are not involved in managing the entity and who are considering whether to provide capital, and at what price. Although those public investors often provide longer-term risk capital, they do not have the power to demand the financial information they might find useful for investment decision-making. They must rely on general purpose financial statements.

An entity's decision to enter a public capital market makes it publicly accountable—and it must provide the outside debt and equity investors with a broader range of financial information than may be needed by users of financial statements of entities that obtain capital only from private sources.

Governments recognise this public accountability by establishing laws, regulations and regulatory agencies that deal with market regulation and disclosures to investors in public securities markets.

The IASB concluded that, regardless of size, entities whose securities are traded in a public market should follow full IFRSs *(see Basis for Conclusions paragraphs BC58 and BC76)*, and such entities should not describe their financial statements as conforming to the *IFRS for SMEs* (see paragraph 1.5).

*Small publicly traded entities*

A jurisdiction that believes that the *IFRS for SMEs* is appropriate for small publicly traded entities in that jurisdiction could incorporate the requirements of the *IFRS for SMEs* into its national standards for small publicly traded entities. In that case, however, the financial statements would be described as conforming to national GAAP. The *IFRS for SMEs* prohibits them from being described as conforming to the *IFRS for SMEs* (see paragraph 1.5).

*Financial institutions*

In most cases, financial institutions are regulated by laws and government agencies. A primary business of banks, insurance companies, securities brokers/dealers, pension funds, mutual funds and investment banks is to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of the entities. Because such an entity acts in a public fiduciary capacity, it is publicly accountable. The *IFRS for SMEs* prohibits such an entity from being described as conforming to the *IFRS for SMEs* (see paragraph 1.5).

## Examples – publicly accountable

Ex 6 **An entity operates two businesses from its premises—banking and retail clothing. Its banking operation takes deposits from the general public in return for a promise to pay to the customer the capital plus a return of 2 per cent of the amount deposited 90 days after receiving the cash (deposit) from the client. The entity uses the funds generated in its banking operation to partially fund its retail clothing operations.**

The entity is publicly accountable—through its banking operation (a primary business) the entity holds assets in a fiduciary capacity for a broad group of outsiders (its banking customers).

Ex 7 **An entity's shares are not listed on a stock exchange but do trade 'over-the-counter' and the over-the-counter market is subject to government regulation though to a lesser degree than the stock exchange.**

The entity is publicly accountable—its shares are traded in a public market.
The regulated over-the-counter market is a public capital market.

Ex 8 **An entity's shares are traded on one of the secondary securities markets in the European Union (EU) that are not 'regulated markets' for the purposes of applying the EU's IAS Regulation (ie EU law does not require the entity to use full IFRSs).**

The entity is publicly accountable—its shares are traded in a public market.
Such markets are public capital markets even if exempt from the IAS Regulation.

## Examples – not publicly accountable

Ex 9 **An entity's only business is earning interest on money that it lends to its clients. The entity obtains all of its funds direct from its two owner-managers both of whom are billionaires (ie the entity does not take deposits from customers).**

The entity is not publicly accountable—its instruments are not traded in a public market and it does not hold assets in a fiduciary capacity for a broad group of outsiders.
The business of lending money to the general public does not itself give rise to public accountability. Note: Banks typically have public accountability because of their deposit-taking activities rather than their lending activities. The entity in this example does not take deposits from a broad group of outsiders—it holds assets only for its two owner-managers.

Ex 10 **The ordinary shares of an entity's parent are listed on a stock exchange.**

The fact that the ordinary shares of an entity's parent are listed on a stock exchange does not, by itself, make the entity (ie the subsidiary) publicly accountable.

Ex 11 **An entity is the only provider of electricity and natural gas in its jurisdiction. The entity is also one of the largest business entities in the jurisdiction and its activities constitute around 4 per cent of the jurisdiction's gross domestic product.**

The fact that the entity provides an essential public service (electricity and natural gas), the size of the entity and its significance in its local economy do not, by themselves, make the entity publicly accountable.

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 organisations, 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), that does not make them publicly accountable.

### Examples – incidental to a primary business

Ex 12 **An entity, whose assets include investment property and demand deposits, prepares its financial statements in compliance with the *IFRS for SMEs*. The entity requires tenants to pay a refundable deposit equal to two months' rental before occupying the entity's investment property. Provided the property rented is not damaged during the tenant's lease term, the entity repays the deposit to the tenant when the tenant vacates the premises at the end of the lease term.**

The holding of rental deposits does not in itself make the entity publicly accountable—the holding of deposits is incidental to the entity's main business. Unless, for other reasons, the entity is publicly accountable, and provided its financial statements comply with all the requirements of the IFRS, the entity must make an explicit and unreserved statement of compliance with the *IFRS for SMEs* in the notes.

Ex 13 **An entity, whose only business is operating a travel agency, prepares its financial statements in compliance with the *IFRS for SMEs*. The entity requires its clients to pay a deposit equal to 60 per cent of the price of package holidays when booking. The balance (40 per cent) is paid 30 days before departure. The deposit is refunded in full provided that the client cancels the booking more than 60 days before the departure date. No refunds are provided for cancellations after 60 days before departure.**

The holding of travel deposits does not in itself make the entity publicly accountable—the holding of deposits is incidental to the entity's primary travel agency business. Unless, for other reasons, the entity is publicly accountable, and provided its financial statements comply with all the requirements of the IFRS, the entity must make an explicit and unreserved statement of compliance with the *IFRS for SMEs* in the notes.

### Examples – not incidental to a primary business

Ex 14 **An entity, whose main business is operating a supermarket, prepares its financial statements in compliance with the *IFRS for SMEs*. In the current reporting period the entity extended its operations to include taking deposits from its customers in return for a promise to return to the customer the capital plus a return of 2 per cent of the amount deposited 90 days after receiving the cash (deposit) from the customer. At the end of the reporting period, the deposit-taking business represents less than 1 per cent of the entity's assets and liabilities. It also represented less than 1 per cent of the entity's profit for the current year.**

The entity is publicly accountable—in the current reporting period the entity started a banking operation in which it holds assets in a fiduciary capacity for a broad group of outsiders (its banking customers). The banking business is not incidental to its supermarket operations (ie it is a second primary business). Because the entity operates a bank business it is publicly accountable. It must not assert compliance with the *IFRS for SMEs* in the notes (see paragraph 1.5).

Note: The entity is publicly accountable even if the deposit-taking activities are not subject to banking regulations in that jurisdiction.

1.5 If a publicly accountable entity uses this IFRS, its financial statements shall not be described as conforming to the *IFRS for SMEs*—even if law or regulation in its jurisdiction permits or requires this IFRS to be used by publicly accountable entities.

### Notes

An entity whose financial statements comply with all the requirements of the *IFRS for SMEs* is required to make an explicit and unreserved statement of such compliance in its financial statements (see paragraph 3.3). However, a publicly accountable entity is prohibited from making this statement even if it is required in law to prepare its financial statements in accordance with the *IFRS for SMEs* (see paragraph 1.5).

An entity that is not publicly accountable and complies with all the requirements of the *IFRS for SMEs* could satisfy the disclosure requirement in paragraph 3.3 as follows:

[Extract from] *Note 2 Basis of preparation and accounting policies*

These financial statements have been prepared in accordance with the *International Financial Reporting Standard (IFRS®) for Small and Medium-sized Entities* issued by the International Accounting Standards Board.

### Examples – compliance statement is not appropriate

Ex 15 **A small community bank that takes deposits from the general public asserts that its financial statements are prepared in compliance with the requirements of the *IFRS for SMEs*. The jurisdiction in which the bank operates has no formal reporting requirements that apply to the entity.**

The entity has public accountability—it holds assets in a fiduciary capacity for a broad group of outsiders as its primary business (see paragraph 1.3(b)). Therefore, it cannot assert that its financial statements comply with the *IFRS for SMEs*.

Ex 16 **An entity whose ordinary shares are traded in jurisdiction A's securities exchange (a public market) asserts that its financial statements are prepared in compliance with the *IFRS for SMEs*. Entities whose ordinary shares are traded in Jurisdiction A's securities exchange are required by local law to prepare their financial statements in accordance with the *IFRS for SMEs*.**

The entity has public accountability—its shares are traded in a public market (see paragraph 1.3(a)). Therefore, it cannot describe its financial statements as complying with the *IFRS for SMEs*. This applies even when the entity is required by law to prepare its financial statements in accordance with the *IFRS for SMEs* (see paragraph 1.5).

Ex 17 **An entity whose debt instruments (but not its shares) are traded in jurisdiction A's securities exchange (a public market) asserts that its financial statements are prepared in compliance with the requirements of the *IFRS for SMEs*.**

The entity has public accountability—its debt instruments are traded in a public market (see paragraph 1.3(a)). Therefore, it cannot describe its financial statements as complying with the *IFRS for SMEs*. This applies even when the entity is required by law to prepare its financial statements in accordance with the *IFRS for SMEs* (see paragraph 1.5).

Ex 18 **An entity that is in the process of listing its ordinary shares in jurisdiction A's securities exchange (a public market) asserts that its financial statements are prepared in compliance with the requirements of the *IFRS for SMEs*.**

The entity has public accountability—it is in the process of issuing its ordinary shares for trading in a public market (see paragraph 1.3(a)). Therefore, it cannot describe its financial statements as complying with the *IFRS for SMEs*. This applies even when the entity is required by law to prepare its financial statements in accordance with the *IFRS for SMEs* (see paragraph 1.5).

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 SMEs*, it must comply with all of the provisions of this IFRS.

### Notes

SMEs should assess their eligibility to use the *IFRS for SMEs* on the basis of their own circumstances, even if they also submit financial information in accordance with full IFRSs to a parent, venturer or investor.

A subsidiary whose parent uses full IFRSs, or is part of a consolidated group that uses full IFRSs, is not permitted to make the simplified disclosures required by the *IFRS for SMEs* and to follow the accounting recognition and measurement principles in full IFRSs that are used by its parent if they are different from the accounting recognition and measurement principles in the *IFRS for SMEs* (ie the *IFRS for SMEs* is a standard appropriate for non-publicly accountable entities, not a 'pick and choose' set of options). If an entity's financial statements are described as conforming to the *IFRS for SMEs*, they must comply with all of the provisions of the *IFRS for SMEs* (see paragraphs 1.6 and 3.3).

Because both full IFRSs and the *IFRS for SMEs* allow accounting policy choices for some recognition and measurement principles, differences between the accounting policies of a parent using full IFRSs and its subsidiaries using the *IFRS for SMEs* can be minimised by particular accounting policy choices. The circumstances in which the *IFRS for SMEs* would mandate a recognition or measurement principle that is different from a measurement under full IFRSs are limited. At 9 July 2009 the following are the principal examples (see paragraph BC68 of the Basis for Conclusions on the *IFRS for SMEs*):

(a) Non-current assets (or groups of assets and liabilities) held for sale

- *IFRS for SMEs*: Holding assets for sale triggers an assessment for impairment, but otherwise no special 'held-for-sale' classification or special accounting requirements.
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*: Measured at lower of carrying amount and fair value less costs to sell. Depreciation stops when classified as held for sale.

(b) Unvested past service cost of defined benefit pension plans

- *IFRS for SMEs*: Recognised in profit or loss immediately.
- IAS 19 *Employee Benefits*: Recognised as an expense on a straight-line basis over the average period until the benefits become vested.

(c) Exchange differences on a monetary item that forms part of the net investment in a foreign operation, in consolidated financial statements

- *IFRS for SMEs*: Recognise in other comprehensive income and do not reclassify in profit or loss on disposal of the investment.
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*: Reclassify in profit or loss on disposal of the investment.

(d) Borrowing costs

- *IFRS for SMEs*: Must be charged to expense.
- IAS 23 *Borrowing Costs*: Costs directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised.

(e) Investment in an associate for which there is a published price quotation

- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
- IAS 28 *Investments in Associates*: Must be measured using the equity method.

(f) Investment in a jointly controlled entity for which there is a published price quotation

- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
- IAS 31 *Interests in Joint Ventures*: Must be measured using the equity method or proportionate consolidation.

(g) Investment property whose fair value can be measured reliably without undue cost or effort

- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
- IAS 40 *Investment Property*: Accounting policy choice of fair value through profit or loss or cost-depreciation-impairment model.

(h) Biological assets

- *IFRS for SMEs*: Measure at fair value through profit or loss only if fair value is readily determinable without undue cost or effort.
- IAS 41 *Agriculture*: Presumption that fair value can be reliably measured.

(i) Income tax

- *IFRS for SMEs*: Where a different tax rate applies to distributed income, initially measure current and deferred taxes at the rate applicable to undistributed profits.

- Exposure draft *Income Tax*: In such a case, initially measure current and deferred taxes at the tax rate expected to apply when the profits are distributed.[1]

(j) Share-based payments with cash alternatives in which the terms of the arrangement provide the counterparty with a choice of settlement

- *IFRS for SMEs*: Account for the transaction as a cash-settled share-based payment transaction unless either the entity has a past practice of settling by issuing equity instruments or the option to settle in cash has no commercial substance.
- IFRS 2 *Share-based Payment*: Accounting akin to a compound instrument.

[1] The proposals of the exposure draft are not the same as the requirements of IAS 12 issued by the IASB at 9 July 2009. The differences are set out on the Comparison with Full IFRS part of Module 29 *Income Tax* of this training material.

## SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

An entity that is publicly accountable must not claim compliance with the *IFRS for SMEs*. In most cases little difficulty is encountered in determining whether an entity is publicly accountable. However, in some cases it might be difficult to determine whether the reasons why an entity holds assets in a fiduciary capacity for a broad group of outsiders is incidental to a primary business of the entity.

## COMPARISON WITH FULL IFRSs

Full IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. The *IFRS for SMEs* is intended to apply to the general purpose financial statements only of entities that do not have public accountability.

## TEST YOUR KNOWLEDGE

Test your knowledge of the characteristics of the entities which are intended to use the *IFRS for SMEs* by answering the questions below.

Once you have completed the test check your answers against those set out below this test.

Assume all amounts are material.

**Mark the box next to the most correct statement.**

### Question 1

In which of the following situations can an entity that does not have public accountability claim compliance with the *IFRS for SMEs* in its financial statements?

- ☐ (a) The entity prepares its financial statements in accordance with local tax requirements that are substantially the same as the *IFRS for SMEs*.
- ☐ (b) The entity prepares its financial statements in accordance with local tax requirements that are, except in name, word-for-word the same as the *IFRS for SMEs*.
- ☐ (c) The entity prepares its financial statements in accordance with local tax requirements that are, except in name, word-for-word the same as full IFRSs.
- ☐ (d) In both cases (b) and (c) above.

### Question 2

In which of the following situations can an entity that does not have public accountability claim compliance with the *IFRS for SMEs* in its financial statements?

- ☐ (a) The entity prepares its financial statements in accordance with local GAAP that is substantially the same as the *IFRS for SMEs*.
- ☐ (b) The entity prepares its financial statements in accordance with local GAAP that is, except in name, word-for-word the same as the *IFRS for SMEs*.
- ☐ (c) The entity prepares its financial statements in accordance with the *IFRS for SMEs*.
- ☐ (d) In both cases (b) and (c) above.

### Question 3

Which of the following entities must not describe its financial statements as being in compliance with the *IFRS for SMEs* even if it is required by law to prepare its financial statements in accordance with the *IFRS for SMEs*?

- ☐ (a) the entity is a subsidiary whose parent uses full IFRSs.
- ☐ (b) the entity is an associate of an investor that uses full IFRSs.
- ☐ (c) the entity is a jointly controlled entity whose venturers (investors) use full IFRSs.
- ☐ (d) cases (a), (b) and (c) above.
- ☐ (e) none of the cases (a)–(c) above.

### Question 4

Which of the following entities must not describe its financial statements as being in compliance with the *IFRS for SMEs* even if it is required by law to prepare its financial statements in accordance with the *IFRS for SMEs*?

☐ (a) an entity that holds assets in a fiduciary capacity for a broad group of outsiders as its primary business (eg a bank).

☐ (b) an entity that operates two divisions in each of its retail outlets—a supermarket and a bank (which holds assets in a fiduciary capacity for a broad group of outsiders)). Both divisions are primary businesses of the entity.

☐ (c) an entity that operates primarily as supermarket chain. However, it also enters into insurance contacts (as the insurer) with its customers. The entity's short-term insurance and life insurance operations are small relative to the size of its supermarket operations and are operated from the entity's supermarkets.

☐ (d) an entity holds assets in a fiduciary capacity for a broad group of outsiders for reasons incidental to a primary business (eg a law firm that is legally required to hold in trust advances from its clients for legal services to be rendered).

☐ (e) cases (a), (b) and (c) above.

☐ (f) cases (a)–(d) above.

### Question 5

Which of the following entities must not describe its financial statements as being in compliance with the *IFRS for SMEs* even if it is required by law to prepare its financial statements in accordance with the *IFRS for SMEs*?

☐ (a) an entity whose shares are traded in a public market (eg a local securities exchange).

☐ (b) an entity whose debt instruments (but not its shares) are traded in a public market (eg a local securities exchange).

☐ (c) an entity that is in the process of issuing its shares for trading in a public market (eg a local securities exchange).

☐ (d) an entity that is in the process of issuing its debt instruments (but not its shares) for trading in a public market (eg a local securities exchange).

☐ (e) cases (a) and (b) above.

☐ (f) cases (a)–(d) above.

## Answers

Q1 (b) see paragraphs 3.3 and 1.5
Q2 (d) see paragraphs 3.3 and 1.5
Q3 (e) see paragraphs 3.3 and 1.6
Q4 (e) see paragraphs 1.2, 1.3(b), 1.4 and 1.5
Q5 (f) see paragraph s 1.2, 1.3(a), 1.4 and 1.5

## APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements of Section 1 *Small and Medium-sized Entities* of the *IFRS for SMEs* by solving the case study below.

Once you have completed the case study check your answer against that set out below this test.

### Case study

A multinational entity (the parent) that is listed on a securities exchange has subsidiaries in many countries. The group prepares its consolidated financial statements using full IFRSs. The subsidiaries prepare their financial statements using the reporting requirements that apply in the jurisdiction in which they are situated (ie local GAAP). In preparing the group's consolidated financial statements for the past reporting period, the financial reporting team first reconciled the financial statements of its subsidiaries from local GAAP to IFRSs. This required knowledge of different local GAAP in 10 jurisdictions.

The group wants to simplify the process of preparing its consolidated financial statements and is considering the following options:

- Option 1: Require subsidiaries to prepare their financial statements in accordance with the recognition and measurement requirements of full IFRSs and provide the disclosures required by the *IFRS for SMEs*.
- Option 2: Require subsidiaries to prepare their financial statements in accordance with the recognition and measurement requirements of the *IFRS for SMEs*, except for financial instruments, which would be recognised and measured in accordance with full IFRSs (ie IAS 39 *Financial Instruments: Recognition and Measurement*), and provide the disclosures required by the *IFRS for SMEs*.
- Option 3: Require subsidiaries to prepare their financial statements in accordance with the recognition and measurement requirements of the *IFRS for SMEs*, except for borrowing costs which would be recognised and measured in accordance with full IFRSs (ie IAS 23 *Borrowing Costs*), and provide the disclosures required by the *IFRS for SMEs*.
- Option 4: Require subsidiaries to prepare their financial statements in accordance with the *IFRS for SMEs*.

None of the debt or equity instruments of any of the subsidiaries are traded in a public market.

The country in which subsidiary J is situated does not permit use of the *IFRS for SMEs*. The countries in which the other subsidiaries are situated either require or permit use of the *IFRS for SMEs* by entities that do not have public accountability. The country in which subsidiary D is situated also requires use of the *IFRS for SMEs* by entities that are publicly accountable.

In the current reporting period subsidiary A embarked on the process of issuing compulsorily redeemable fixed-rate debentures in the domestic stock exchange (a public market).

Subsidiary B's primary business is the operation of an independent school (private school). When applying for a place at the school a deposit is paid to the entity by the applicant. If the application is not successful, the deposit is refunded to the applicant when the applicant is informed that their application was unsuccessful. If the applicant is granted a place at the school the deposit is refunded when the student leaves the school. If the applicant is granted a place at the school but chooses not to take up that place, the deposit is forfeited by the applicant.

Subsidiary C operates a travel agency. It requires its clients to pay a deposit equal to 80 per cent of the price of package holidays when booking. The balance (20 per cent) is paid 30 days before departure. The deposit is refunded in full provided that the client cancels the booking more than 60 days before the departure date. No refunds are provided for cancellations within 60 days of departure.

Subsidiary D's main business is retailing food. As a 'side-line', it also take deposits from its customers in return for a promise to return to the customer the capital plus a return of 3 per cent of the amount deposited 120 days after receiving the cash (deposit) from the customer.

Subsidiary E's main business is retailing food. It also provides its employees with short-term interest-free loans so that they can purchase annual rail cards to travel by train between their homes and their place of work. The loan is repaid by the entity deducting the repayments from the employees' salaries in 12 equal monthly instalments.

All of the entity's other subsidiaries retail clothing.

**Part A: Which subsidiaries of the multinational entity are eligible to use the *IFRS for SMEs*?**

**Part B: Which of the options being considered by the multinational entity to simplify the preparation of its consolidated financial statements do not contravene the *IFRS for SMEs*?**

## Answer to case study—Part A

All of the subsidiaries, except subsidiaries A and D, are small or medium-sized entities as defined by the International Accounting Standards Board (IASB). As explained below, nothing in the *IFRS for SMEs* prevents the subsidiaries, other than subsidiaries A and D, from preparing their financial statements in accordance with the *IFRS for SMEs*. However, regulation of the jurisdiction in which subsidiary J operates prohibits subsidiary J from using the *IFRS for SMEs*.

*Background information*

SMEs must assess their eligibility to use the *IFRS for SMEs* on the basis of their own circumstances, even if they also submit financial information in accordance with full IFRSs to their parent. There are two questions about an entity's eligibility to use the *IFRS for SMEs*: (i) does the entity satisfy the IASB's definition of a small or medium-sized entity? and (ii) is the entity required or permitted in law to use the *IFRS for SMEs*?

Decisions on which entities are required or permitted to use the *IFRS for SMEs* rest with legislative and regulatory authorities and standard-setters in individual jurisdictions (paragraph 13 of the preface to the *IFRS for SMEs*). However, a clear definition of the class of entity for which the *IFRS for SMEs* is intended is essential so that 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 SMEs* and so that entities that are not small or medium-sized entities, and are therefore not eligible to use the *IFRS for SMEs*, do not assert that they are in compliance with it (see paragraph 1.5).

Accordingly some entities that satisfy the IASB's definition of SMEs could be prohibited from reporting using the *IFRS for SMEs* in the jurisdiction in which they operate (eg see subsidiary J below). Conversely, other entities that do not satisfy the IASB's definition of SMEs could be required by law to report using the *IFRS for SMEs* in the jurisdiction in which they operate (eg see subsidiary D below).

*Fail the IASB's definition of SMEs*

Subsidiaries A and D are publicly accountable and therefore are not small or medium-sized entities as defined in the *IFRS for SMEs*. Subsidiary A is publicly accountable because it is in the process of issuing debt instruments for trading in a public market (see paragraph 1.3(a)). Subsidiary D has public accountability because in its banking operation it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses—(see paragraph 1.3(b)). The banking business is not incidental to its food retailing operations.

Note: The fact that entity D is required by law to prepare its financial statements does not bring entity D into the IASB's definition of SMEs. In accordance with paragraph 1.5 of the *IFRS for SMEs* the entity must not describe its financial statements as conforming to the *IFRS for SMEs*.

Regulation in the jurisdiction in which subsidiary J operates does not permit use of the *IFRS for SMEs*. This does not prevent the subsidiary J from satisfying the IASB's definition of a small or medium-sized entity.

*SMEs as defined by the IASB*

Like subsidiary D, subsidiaries B and C also holds assets in a fiduciary capacity for a broad group of outsiders. However, because (unlike subsidiary D) subsidiaries B and C do so for reasons incidental to their primary businesses this does not make them publicly accountable (see paragraph 1.4). Unless other factors give subsidiaries B and C public accountability, they satisfy the IASB's definition of SMEs.

All of the other subsidiaries in the group also appear to be SMEs as defined by the IASB (ie they prepare general purpose financial statements and do not have public accountability). The fact that subsidiary E provides its employees with short-term interest-free loans does not give rise to public accountability. The provision of loans in itself does not amount to holding assets in a fiduciary capacity for a broad group of outsiders.

## Answer to case study—Part B

**Option 1: Require subsidiaries to prepare their financial statements in accordance with recognition and measurement requirements of full IFRSs and provide the disclosures required by the *IFRS for SMEs*.**

This option cannot be adopted by the entity because it contravenes the *IFRS for SMEs*—a subsidiary whose parent uses full IFRSs, or is part of a consolidated group that uses full IFRSs, is not permitted to make the simplified disclosures required by the *IFRS for SMEs* and to follow the accounting recognition and measurement principles in full IFRSs that are used by its parent if they are different from the accounting recognition and measurement principles in the *IFRS for SMEs* (ie the *IFRS for SMEs* is a standard appropriate for non-publicly accountable entities, not a 'pick and choose' set of options). If an entity's financial statements are described as conforming to the *IFRS for SMEs*, it must comply with all of the provisions of the *IFRS for SMEs* (see paragraphs 1.6 and 3.3).

Notes:

Because the *IFRS for SMEs* offers accounting policy choices for some recognition and measurement principles, differences from full IFRSs can be minimised by an entity's accounting policy choices. The circumstances in which the *IFRS for SMEs* would mandate a recognition or measurement principle that is different from measurement under full IFRSs are limited. At 9 July 2009 the following are the principal examples (see paragraph BC68 of the Basis for Conclusions on the *IFRS for SMEs*):

(a) Non-current assets (or groups of assets and liabilities) held for sale

- *IFRS for SMEs*: Holding assets for sale triggers an assessment for impairment, but otherwise no special 'held-for-sale' classification or special accounting requirements.
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*: Measured at lower of carrying amount and fair value less costs to sell. Depreciation stops when classified as held for sale.

(b) Unvested past service cost of defined benefit pension plans

- *IFRS for SMEs*: Recognised in profit or loss immediately.
- IAS 19 *Employee Benefits*: Recognised as an expense on a straight-line basis over the average period until the benefits become vested.

(c) Exchange differences on a monetary item that forms part of the net investment in a foreign operation, in consolidated financial statements

- *IFRS for SMEs*: Recognise in other comprehensive income and do not reclassify in profit or loss on disposal of the investment.
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*: Reclassify in profit or loss on disposal of the investment.

(d) Borrowing costs

- *IFRS for SMEs*: Must be charged to expense.
- IAS 23 *Borrowing Costs*: Costs directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised.

(e) Investment in an associate for which there is a published price quotation

- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
- IAS 28 *Investments in Associates*: Must be measured using the equity method.

(f) Investment in a jointly controlled entity for which there is a published price quotation

- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
- IAS 31 *Interests in Joint Ventures*: Must be measured using the equity method or proportionate consolidation.

(g) Investment property whose fair value can be measured reliably without undue cost or effort

- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
- IAS 40 *Investment Property*: Accounting policy choice of fair value through profit or loss or cost-depreciation-impairment model.

(h) Biological assets

- *IFRS for SMEs*: Measure at fair value through profit or loss only if fair value is readily determinable without undue cost or effort.
- IAS 41 *Agriculture*: Presumption that fair value can be reliably measured.

(i) Income tax

- *IFRS for SMEs*: Where a different tax rate applies to distributed income, initially measure current and deferred taxes at the rate applicable to undistributed profits.
- Exposure draft *Income Tax*: In such a case, initially measure current and deferred taxes at the tax rate expected to apply when the profits are distributed.[(2)]

(j) Share-based payments with cash alternatives in which the terms of the arrangement provide the counterparty with a choice of settlement

- *IFRS for SMEs*: Account for the transaction as a cash-settled share-based payment transaction unless either the entity has a past practice of settling by issuing equity instruments or the option to settle in cash has no commercial substance.

- IFRS 2 *Share-based Payment*: Accounting akin to a compound instrument.

**Option 2: Require subsidiaries to prepare their financial statements in accordance with the recognition and measurement requirements of the *IFRS for SMEs*, except for financial instruments, which would be recognised and measured in accordance with full IFRSs (ie IAS 39 *Financial Instruments: Recognition and Measurement*), and provide the disclosures required by the *IFRS for SMEs*.**

This option can be adopted by those subsidiaries that do not have public accountability (ie excluding subsidiaries A and D—see the answer to part A) and are not otherwise prevented from applying the *IFRS for SMEs* (ie excluding subsidiary J—see the answer to part A).

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[(2)] The proposals of the exposure draft are not the same as the requirements of IAS 12 issued by the IASB at 9 July 2009. The differences are set out on the Comparison with Full IFRS part of Module 29 *Income Tax* of this training material.

In accordance with paragraph 11.2 an entity can choose to apply either the provisions of both Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* in full or the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement* and the disclosure requirements of Sections 11 and 12.

**Option 3: Require subsidiaries to prepare their financial statements in accordance with the recognition and measurement requirements of the *IFRS for SMEs*, except for borrowing costs, which would be recognised and measured in accordance with full IFRSs (ie IAS 23 *Borrowing Costs*), and provide the disclosures required by the *IFRS for SMEs*.**

This option cannot be adopted by the entity because it contravenes the *IFRS for SMEs*—a subsidiary whose parent uses full IFRSs, or is part of a consolidated group that uses full IFRSs, is not permitted to follow selected recognition and measurement principles in full IFRSs that are used by its parent if they are different from the accounting recognition and measurement principles in the *IFRS for SMEs* (ie the *IFRS for SMEs* is a standard appropriate for non-publicly accountable entities, not a 'pick and choose' set of options). The only exemption to this principle is in respect of the recognition and measurement of financial instruments (see option 2 above). However, that exception does not extend to the capitalisation of borrowing costs.

If an entity's financial statements are described as conforming to the *IFRS for SMEs*, it must comply with all of the provisions of the *IFRS for SMEs* (see paragraphs 1.6 and 3.3).

**Option 4: Require subsidiaries to prepare their financial statements in accordance with the *IFRS for SMEs*.**

This option can be adopted by those subsidiaries that do not have public accountability (ie excluding subsidiaries A and D—see the answer to part A) and are not otherwise prevented from applying the *IFRS for SMEs* (ie excluding subsidiary J—see the answer to part A).