Micro-entities
Financial Reporting Challenges

13th Emerging Economies Group Meeting
8-9 May, 2017
Mumbai, India

Accounting Standards Board (ASB)

The Institute of Chartered Accountants of India

Agenda for Discussion

1	Micro Entities- Key Features
2	Micro Entities- Definition Criteria
3	Micro Entities- Current Scenario: India, UK, IFRS, US
4	Micro Entities- Financial Reporting Challenges
5	Micro Entities- Going Forward: Key issues to be addressed

Micro-Entities: Key Features

Ownership & Management	Concentrated/Non-public interest entities
Legal Structure of Entity	No specific structure but generally are proprietorship firms, partnership firms, LLP,s small companies
Business size and complexity	Small size involving less complexities
Financial Reporting Objectives and Purpose	No public accountability

Micro-Entities:
Current scenario: India

India's segregation of entities for accounting

- **Company**
  - **Public Interest Company**
    - Listed Company
    - Unlisted company having net worth above Rs. 250 crores
    - Other unlisted entity which is Non-SMC
  - **Small & Medium Sized Company (SMC)**
- **Non-Company**
  - Level I Entity
  - Level II Entity
  - Level III Entity

Level II Entity and Level III Entity: **SMEs**

Level III Entity: **CAN BE CONSIDERED AS MICRO-ENTITIES**

Micro-Entities:
Current scenario: India

In India, IFRS for SMEs has not been adopted or converged

Listed company Unlisted company having net worth above Rs. 250 crores	IFRS (Full) converged Ind AS notified under the Companies (Indian Accounting Standards) Rules, 2015 by MCA
Unlisted company having net worth less than Rs. 250 crores	AS notified by MCA under Companies (Accounting Standards) Rules, 2006
SMCs	AS notified by MCA under Companies (Accounting Standards) Rules, 2006 **with certain relaxations** given in later slides
Non-Company	AS prescribed by ICAI which are similar to those notified by MCA under Companies (Accounting Standards) Rules, 2006
SMEs (Level II & Level III)	AS prescribed by ICAI **with certain relaxations** given in later slides

Micro-Entities: Definition Criteria

	India	UK	IFRS
Is there a separate definition of 'Micro-entities' and 'SME'?	• 'Micro-entities' are not defined. • Criteria for classification as SMEs/SMCs is specified	Criteria for classification as Micro Entities is specified	SMEs are defined in IFRS for SMEs
Does it take into account 'Public Accountability' ?	Yes	Not directly	Yes
What are the other crtieria ?			
Turnover	SMCs- less than Rs.50 crores Level I I SME- less than Rs. 50 crores but more than Rs. 1 crore Level III SME- less than Rs. 1 crore	Less than £632,000	-
Balance Sheet Size	-	Less than £316,000	-
Number of Employees	-	10	-

Micro-Entities: Definition Criteria

	India	UK	IFRS
Any other criteria	**SMCs:** • Company whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; • Company which is not a bank, financial institution or an insurance company; • Company which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; • Not a holding or subsidiary company of a non-SMC **SMEs:** **Level II:** • All commercial, industrial and business reporting entities having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crore at any time during the immediately preceding accounting year. • Holding and subsidiary entities of entities falling in Level II **Level III:** Entities, which are not covered under Level I and Level II	-	-

Micro-Entities:
Current scenario: India

RELAXATIONS FOR SMCS/SMES

	SMEs (Level II & III)	SMCs
AS not applicable (applicable if entity prepares CFS)	AS 3, Cash Flow Statement AS 17, Segment Reporting AS 21, Consolidated Financial Statements AS 23, Accounting for Investments in Associates in Consolidated Financial Statements AS 27, Financial Reporting of Interests in Joint Ventures AS 25, Interim Financial Reporting **In addition to above, following Standards are not applicable to Level III entities:** AS 18, Related Party Disclosures AS 24, Discontinuing Operations	AS 3, AS 17 AS 25

Micro-Entities:
Current scenario: India

RELAXATIONS FOR SMCS/SMES

	SMEs (Level II)	SMEs (Level III)	SMCs
Measurement Related Exemptions			
Exemptions from AS 15 , *Employee Benefits,* requirements	***Average number of persons employed during the year is 50 or more***		
	A. Recognition and measurement requirements of the Standard relating to non-vesting short-term accumulating compensated absences may not be followed B. Contribution to defined contribution plan and termination benefits that fall due more than 12 months after the balance sheet date need not to be discounted C. Recognition and measurement principles and presentation and disclosure requirements given in the Standard in respect of accounting for defined benefit plans & recognition and measurement principles in respect of accounting for other long-term employee benefits may not be followed. However, actuarially determined accrued liability to be provided for, for this purpose; • Projected Unit Credit method to be followed, • Discount rate used should be determined by reference to market yields at the balance sheet date on government bonds & actuarial assumption to be disclosed)		Same as SMEs

Micro-Entities:
Current scenario: India

RELAXATIONS FOR SMCS/SMES

	SMEs (Level II)	SMEs (Level III)	SMCs
Measurement Related Exemptions			
Exemptions from AS 15 , *Employee Benefits,* requirements	***Average number of persons employed is less than 50***		
	Similar as above except that Projected Unit Credit method is not mandatory. Any rational method can be used.		-

Micro-Entities:
Current scenario: India

RELAXATIONS FOR SMCS/SMES

	SMEs (Level II and III) & SMCs
AS 28, *Impairment of Assets*	Allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique Consequently, such entity/company chooses to measure the 'value in use' by not using the present value technique, the relevant provisions of AS 28, such as discount rate etc., would not be applicable Such an entity and SMC need not disclose the discount rate(s) used in the current estimate and previous estimate (if any) of value in use if the recoverable amount is value in use.

Micro-Entities:
Current scenario: India

RELAXATIONS FOR SMCS/SMES

	SMEs (Level II & III) & SMCs
Disclosure Exemptions	
AS 19, *Leases*	**Books of Lessee** a) In case of finance lease, a reconciliation between the total of minimum lease payments at the balance sheet date and their present value b) Total of minimum lease payments at the balance sheet date in case of finance and operating lease and present value in case of finance lease c) Total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date in case of in finance and operating lease d) Description of the lessee's significant leasing arrangements in case of in finance and operating lease

Micro-Entities:
Current scenario: India

RELAXATIONS FOR SMCS/SMES

	SMEs (Level II & III) & SMCs
Disclosure Exemptions	
AS 19, *Leases*	**Books of lessor** a) Total of future minimum lease payments under non-cancellable operating lease b) Reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date in case of finance lease c) In case of finance lease, total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date d) Description of the lessor's significant leasing arrangements in case of in finance and operating lease **Additionally, in case of level III entities, lessor shall also not disclose accounting policy adopted in respect of initial direct costs with respect to operating leases.**

Micro-Entities:
Current scenario: India

RELAXATIONS FOR SMCS/SMES

	SMEs (Level II & III) & SMCs
Disclosure Exemptions	
AS 20, *Earnings Per Share*	Disclosure of Diluted earnings per share (both including and excluding extraordinary items) is exempted **Certain additional disclosures are exempted for Level III entities such as nominal value of shares along with the earnings per share figures.**

Micro-Entities:
Current scenario: India

RELAXATIONS FOR SMCS/SMES

	SMEs (Level II & III) & SMCs
Disclosure Exemptions	
AS 29, *Provisions, Contingent Liabilities and Contingent Assets*	Disclosures exempted for each class of provision, (a) the carrying amount at the beginning and end of the period; (b) additional provisions made in the period, including increases to existing provisions; (c) amounts used (i.e. incurred and charged against the provision) during the period; (d) unused amounts reversed during the period (e) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits; (f) an indication of the uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events; (g) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement

Micro-Entities:
Proposed scenario: India

- ✓**In India, a project for revising the existing set of Accounting Standards is being undertaken.**
- ✓**The revised set of Accounting Standards would be applicable to small and medium companies**
- ✓**For micro-entities, no separate project for further simplification of Standards is being undertaken.**
- ✓**Key decisions of ICAI Council approved Concept paper for revising the existing AS**
  - Changes to improve the recognition principles in the existing Accounting Standards
  - Lesser use of fair values
  - Incorporating less onerous treatment in an Ind AS
  - Where accounting principles does not exist in the existing AS but exists in Ind AS, the same should be included while revision
  - Optimal disclosures

Micro-Entities:
Proposed scenario: India

✓**Key decisions of ICAI Council approved Concept paper for revising the existing AS (contd..)**

- Relaxations in respect of measurement principles:
  - Minimum use of fair value model, including time value of money
  - Omitting complex measurements in Ind AS
  - Where the measurement models in Ind AS and existing AS are conceptually different and the model under Ind AS is superior to that under AS, the former may be followed albeit with simplifications as appropriate

- IFRS for SMEs is also considered while revising the existing AS- Where relaxations/exemptions compared to full IFRS are allowed under the IFRS for SMEs will be considered.

Micro-Entities:
Current scenario: UK

✓In U.K, there are three set of Standards.

✓Financial reporting standards of micro-entities are much simpler than the financial reporting standards of small entities.

✓FRS 105 is a single accounting standard for use by entities that are eligible for, and choose to apply the micro-entities regime. It is based on FRS 102, i.e., financial reporting standards applicable to small entities.

✓The standard comprises 28 sections, each dealing with a specific area of accounting.

✓FRS 105 came into force for accounting periods beginning on or after 1 January 2016 although early application is permitted.

Micro-Entities:
Current scenario: UK

KEY RELAXATIONS IN FRS 105 COMPARED TO FRS 102

✓FRS 105 requires that micro-entities prepare a balance sheet and profit and loss account; however other primary statements are not required.

✓The standard requires only limited disclosures.

✓FRS 105 prohibits revaluing or subsequently measuring assets or liabilities at fair value.

✓No deferred tax or equity-settled share-based payment amounts are recognised and accounting choices set out in FRS 102 are removed.

Micro-Entities:
Current scenario: US FASB

"Blue-Ribbon" Panel (BRP) was established by following entities in December 2009 to address how Accounting Standards can best meet the needs of users of U.S. private company:

- Financial statements American Institute of Certified Public Accountants (AICPA),
- Financial Accounting Foundation (FAF),
- Parent organization of the Financial Accounting Standards Board (FASB), &
- National Association of State Boards of Accountancy (NASBA)

Micro-Entities:
Current scenario: US FASB

BRP RECOMMENDATIONS ON STANDARD-SETTING MODEL AND STRUCTURE

- ✓ **GAAP with exceptions and modifications for private companies (with process enhancements)**
- ✓ **Separate private company accounting standards board**

BRP believes that significant change is needed in the system of setting accounting standards for private companies to address the issues underlying the lack of relevance of a number of GAAP standards for many users of private company GAAP financial statements and the complexity of GAAP for private companies.

Micro-Entities:
Current scenario: US FASB

PRIVATE COMPANY DECISION-MAKING FRAMEWORK (GUIDE) ISSUED IN DECEMBER, 2013

✓In July 2011, the FASB staff completed an assessment of

(a) how and why the needs of users of private company financial statements may differ from the needs of users of public company financial statements and

(b) how the cost-benefit considerations of financial reporting may vary between private companies and public companies.

✓The assessment identified the following five significant factors that in varying degrees may differentiate the financial reporting considerations of private companies from those of public companies:

I. Number of primary users and their access to management
II. Investment strategies of primary users
III. Ownership and capital structure
IV. Accounting resources
V. Learning about new financial reporting guidance.

Micro-Entities:
Current scenario: US FASB

PRIVATE COMPANY DECISION-MAKING FRAMEWORK (GUIDE) ISSUED IN DECEMBER, 2013

✓Part of the ongoing commitment of the FASB and the Private Company Council (PCC) to consider the needs of both users and preparers of private company financial statements.

✓One of the most important recommendations included in the January 2011 Report to the Board of Trustees of the Financial Accounting Foundation by the Blue-Ribbon Panel on Standard Setting for Private Companies.

✓The primary purpose of this Guide is to assist the Board and the PCC in determining whether and in what circumstances to provide alternative recognition, measurement, disclosure, display, effective date, and transition guidance for private companies reporting under U.S. GAAP.

✓This Guide discusses the following five areas in which financial accounting and reporting guidance might differ for private companies and public companies:

a. Recognition and measurement
b. Disclosures
c. Display (or presentation)
d. Effective date
e. Transition method.

Micro-Entities:
Current scenario: IFRS

- ✓For the SMEs, IASB intends to apply IFRS for SMEs to the general purpose financial statements only of entities that do not have public accountability.

- ✓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 based on full IFRS with modifications to reflect the needs of users of SMEs' financial statements and cost-benefit considerations.

Micro-Entities:

Current scenario: IFRS

RELAXATIONS GIVEN IN IFRS FOR SMES

Examples of some topics which are omitted if irrelevant to private entities	Segment reporting
	Earnings per share
	Insurance
	Interim reporting
	Assets held for sale
Simplified Drafting	
Reduced Disclosures	More than 3000 items in the disclosure checklist in the Full IFRS
	IFRS for SMEs contain only 300 disclosures

Micro-Entities:
Current scenario: IFRS

RELAXATIONS GIVEN IN IFRS FOR SMES

Examples of Omitted Complex Options	Financial instruments options including available for sale option, held to maturity option, fair value option, embedded derivatives
	Revaluation of PP&E and intangibles
	Free choice on investment property
	Various options for government grants
Recognition and measurement simplifications (Contd..)	Financial instruments: two classifications, not four, drop "continuing involvement approach" for derecognition, much simplified hedge accounting
	Goodwill amortisation
	Goodwill impairment – indicator approach
	Expense all R&D
	Cost method for associates and JVs

Micro-Entities:
Current scenario: IFRS

RELAXATIONS GIVEN IN IFRS FOR SMES

Recognition and measurement simplifications

(Contd..))

Share-based payment – can use directors' judgement in estimating value

First-time adoption: Less prior data

Defined benefit plans:

- No corridor or deferrals
- Simplified calculation of obligation

Expense all borrowing costs

Much less fair value for agriculture

Micro-Entities: Financial Reporting Challenges

General

- ✓Private companies are incurring significant unnecessary cost for GAAP financial statement preparation and audit, review, or compilation services.
- ✓Accounting standards are primarily designed to meet the needs of equity analysts. There are certain disclosure requirements that do not provide any incremental benefit to the users of private company financial statements.
- ✓Many of the most costly standards for private companies to implement contain complex disclosures that focus on information that their users do not understand and which does not provide value to the users. Bankers will often ignore fair value disclosures because of this reason.
- ✓Complexity of the standards are exposing firms to additional liability and risk because they do not have the in-house capabilities and time to stay abreast of the changing standards.

Micro-Entities: Financial Reporting Challenges

General

Disclosures

Relevance of the Standards in view of limited users

Recognition and Measurement Principles

Lack of resources and skill set

Involvement of higher costs of compliance as compared to the benefits

Increased pace of standard setting

Micro-Entities: Financial Reporting Challenges

Examples

- *Classification of assets and liabilities as current/non-current*
- *Accounting for finance leases*
- *Discounting of long term provisions*
- *Estimation of value in use for impairment purposes*
- *Financing transactions and deferred consideration*
- *Depreciation calculation of PPE having significant parts with different useful lives based on each individual part's life*
- *Deferred Tax-Balance Sheet vs. Profit & Loss Approach*

Micro-Entities: Financial Reporting Challenges

Examples

Application of Standard on business combinations

Determination of Fair value

Application of Standard on Financial Instruments

Preparation of Consolidated Financial Statements

Micro-Entities:
Going Forward: Key issues to be addressed

- ✓Determining the criteria for identifying micro entities
- ✓Though IASB has developed IFRS for SMEs, still there are challenges in the implementation of these standards by the micro-entities.
- ✓On this account, IASB may consider formulating a new reporting Standard for micro entities similar to micro-entities in UK further simplifying or omitting the complex measurement, recognition and disclosure requirements.
- ✓In the process of simplification of Standards, true and fair view of financial statements should not be compromised at the cost of simplification.

THANK YOU

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