24th DAAAM International Symposium on Intelligent Manufacturing and Automation, 2013

Comparison of Approaches to Financial Reporting of Non-Current Assets According to the IFRS for SMEs and IAS/IFRS

Hinke Jana, Zborková Jitka*

Faculty of Economics, University of West Bohemia, Univerzitni 8, Pilsen 306 14, Czech Republic

Abstract

The aim of this paper is to compare the policies for measurement, depreciation and recognition of tangible fixed assets according to the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) and according to the full version of the International Financial Reporting Standards (IAS/IFRS). In addition, the paper presents results of an empirical research into the awareness level of respondents (economists and chief accountants of small and medium-sized enterprises in the Czech Republic) as to the IAS/IFRS and IFRS for SMEs accounting system.

1. Introduction and critical overview of literature sources

"Accounting poses as being exact. Not so. Accounting numbers, such as net income and total assets, are the reset of a collection of arbitrary estimates, allocations and different accounting conventions." [10]

Accounting systems are primarily characterized by accounting principles, valuation bases, accounting methods (e.g. accounting procedures) and financial statements (by the structure and contents of financial statements) Despite considerable efforts to harmonize financial reporting of entrepreneurs, in the world there is a considerable number of accounting systems that vary significantly. [1]

For the purpose of decision making, it is necessary to have comparable financial statements [6].The IAS/IFRS accounting system was also inspired by the need to compare financial data at the international level [5]. The decision

* Corresponding author:Tel.: +420-377-633-217; fax: +420-377-633-002.
*E-mail address:*prochaz2@kfu.zcu.cz

on which entities will be required or allowed to use these standards depends on the national legislative and regulatory bodies and authors of standards in individual countries. This fact applies not only to the full version of the IAS/IFRS standards, but also to the International Financial Reporting Standard for Small and Medium-sized Entities. However, the IAS/IFRS has become an obligatory accounting system by the Regulation (EC) No 1606/2002 of the European Parliament and of the Council [4] for all entities that are publicly traded companies and also issue securities on the European regulated market. Over 80 jurisdictions have either adopted the IFRS for SMEs or stated a plan to do so within the next few years. For the EU member states the IFRS for SMEs is a voluntary instrument of harmonization of financial reporting [8].

Non-current assets are one of the primary issues of these accounting systems, because they are an integral part of assets of most business entities [9]. To define the accounting policies, at first, it is necessary to identify sources which, within the IAS/IFRS and the IFRS for SMEs, describe the issues of non-current assets.

Table 1.Sources of the policies for measurement, depreciation and recognition of non-current assets.

Accounting system/ Class of non-current assets	Non-current assets held for production, supply of goods or services and for administration purposes (Property, plant and equipment)	Non-current assets held for sale	Investment property	Biological Assets
IFRS for SMEs	Section 17	Section 17	Section 16	Section 34
IAS/IFRS	IAS 16	IFRS 5	IAS 40	IAS 41

Source: author´s own elaboration, 2013

The IFRS for SMEs deals with the issues of non-current assets in sections 16: Investment Property, 17: Property, Plant and Equipment, and 34: Specialised Activities. The full version of the IAS/IFRS standards contains the given issues in the standard of IAS 16: Property, Plant and Equipment, IAS 40: Investment Property, IAS 41: Agriculture and IFRS 5: Non-current Assets Held for Sale and Discontinued Operation.

2. Objective and methods used

The paper is based on two pillars. The first pillar aims to compare the policies for measurement, depreciation and recognition of non-current assets according to the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) and according to the full version of the International Financial Reporting Standards (IAS/IFRS) that are intended for companies trading their securities on the EU regulated market according to the Regulation (EC) No 1606/2002 of the European Parliament and of the Council.

The second pillar presents partial results of a research entitled "Developing a New Concept of Financial Reporting for Small and Medium-sized Entities in the Czech Republic". This is an evaluation of outcomes from the questionnaire survey, whose purpose was to find out whether the small and medium-sized enterprises in the Czech Republic are informed of the IFRS for SMEs and whether the respondents (especially economists and chief accountants of these small and medium-sized enterprises) can tell the difference between the IFRS for SMEs and the national accounting standard, and can thus define the benefits of this financial reporting. A group of 150 respondents (economists and chief accountants) was the basis for an appropriate sample of SMEs. These respondents underwent the testing according to the preselected criteria and were sent the questionnaires. Out of the total sample of 150 questionnaires, 104 were completed without an error.

The topic of this paper is specifically focused on non-current assets, which are analysed by the following classes:

a)   non-current assets held for production, supply of goods or services, and for administrative purposes,
b)   non-current assets held for sale,
c)   investment property,
d)   non-current assets of biological nature.

The aim of this paper is to confirm, or disprove the following hypotheses:

H1   The accounting policies defined by the IFRS for SMEs are not in full compliance with the policies of thematically relevant standards of IAS/IFRS; therefore, the entity in transition from the IFRS for SMEs to the IAS/IFRS would have to make adjustments.

H2   The vast majority of small and medium-sized entities in the Czech Republic are not at all informed of the IFRS for SMEs or IAS/IFRS financial reporting, which implies that respondents from the aforesaid enterprises are not able to define benefits of these accounting systems as distinct from the national regulation of financial reporting.

The basic problem, of which the paper is based, is a reflection on the low awareness of small and medium enterprises of the International Financial Reporting Standard IFRS for SME.

3. Progress and results of research

When studying the text of the international financial reporting standards, narrowing of the scope of the IFRS for SMEs provisions from the full version of the IAS/IFRS for listed companies must be obvious to every reader. This fact may encourage the idea whether the narrowing of the text also means restrictions in the choice of measurement methods, depreciation methods and disclosure requirements.

3.1. Comparison of policies within tangible fixed assets according to the IFRS for SMEs and according to the IAS/IFRS

The following summary may be compiled from the policies for financial reporting included in the IAS/IFRS standards and sections of the IFRS for SMEs regarding the tangible fixed assets:

Table 2.Summary of policies for the financial reporting of non-current assets according to the IFRS for SMEs.

Policy / Class of assets	Non-current assets held for production, supply of goods or services, and for administrative purposes	Non-current assets held for sale	Investment Property	Non-current assets of biological nature
Measurement at recognition	Costs (Purchase price, any costs directly attributable to bringing the asset to the location and condition, the costs of dismantling and removing the item and restoring the site on which it is located).	Carrying amount of the asset disposed (costs)	Costs (Purchase price and directly attributable expenses)	Fair value less costs to sell (costs only if the fair value cannot be determined without undue cost and effort)
Measurement after recognition	Costs less any accumulated depreciation and any accumulatedimpairment losses.	Costs less any accumulated depreciation and any accumulated impairment losses.	Fair value (If determinable without undue cost and effort). Changes in fair value are recognized in profit or loss.	Fair value less costs to sell. Changes in fair value are recognized in profit or loss.
Impairment of Assets	If the recoverable amount is lower than the carrying amount.	If the recoverable amount is lower than the carrying amount.	It is expressed in the movement of fair value.	It is expressed in the movement of fair value.
Depreciation	It is recognized in profit or loss. The component method of depreciation must be applied.	Not defined.	If the fair value is determinable without undue cost or effort – it is not depreciated.	If the fair value measurement is chosen – it is not depreciated.

| Disclosure | For each class of property, it is necessary, above all, to disclose the depreciation methods used, the useful lives, the accumulated depreciation and the comparison of the carrying amount at the beginning and end of the reporting period. | Not excluded from section 17. | It is necessary, above all, to disclose the methods and assumptions applied in determining the fair value, the comparison between the carrying amount at the beginning and end of the reporting period et seq. | It is necessary, above all, to disclose the methods and significant assumptions applied in determining the fair value of each class of biological assets, the comparison of changes in the carrying amount at the beginning and end of the reporting period et seq. |

Source: author´s own elaboration according to [8], 2013.

Table 3.Summary of policies for the financial reporting of non-current assets according to the IAS/IFRS.

Rule/Class of assets	Non-current assets held for production, supply of goods or services, and for administrative purposes	Non-current assets held for sale	Investment Property	Non-current assets of biological nature
Measurement at recognition	Costs (including the option to increase costs by inventories)	On the basis of the prudence principle - based on the lower of the two values: the fair value less costs to sell and the carrying amount.	Costs	Fair value (less estimated costs to sell). Acquisition costs are accepted only in exceptional cases.
Measurement after recognition	The possibility to choose between the Cost Model and Revaluation Model (at fair value).	The measurement of assets, with an increase in the fair value (less costs to sell) in the future periods, must not retroactively increase above the originally recognized impairment.	The possibility to choose between the Fair Value Model and Cost Model.	Fair value (The standard also regulates the determination of a market price when there is no active market). The profit/loss from revaluation is included in the net profit/loss for the relevant period.
Impairment of Assets	As for the cost model, these are the impairment losses. The fair value model can express the decrease or increase in the value of asset by the fair value.	An impairment loss on assets held for sale or any retroactive increase in the value of these assets will always affect the profit or loss.	When using the cost model, the value can be decreased by the accumulated impairment losses; when using the fair value model, the fair value itself reflects the decrease or increase.	By creating impairment losses in the measurement of biological assets at costs (in exceptional cases).
Depreciation	This is the allocation of costs or carrying amount after revaluation to the expenses of the company. Depreciation affects profit or loss unless it is included in the measurement of another asset. The component	The assets are no longer depreciated, since they are not used. Only their impairment is tested.	The property investment measured at the fair value is not depreciated. Changes in the fair value reflect the changes in the value and therefore depreciation in this case makes no sense. When measuring by the cost model it is usually	If biological assets are measured at costs.

	method of depreciation must be applied.		depreciated.	
Disclosure	Particularly the measurement model, the depreciation method used and the analysis of overall changes as well as restrictions of property rights must be recognized in each class of assets.	Separately from other assets. Individual classes of assets for sale are stated either directly in the balance sheet or in the notes to the financial statements.	It is necessary to disclose, in particular, the criteria for classification of the assets into a group of property investments, as well as the measurement model used, the method applied in determining the fair value and rent received from investment property and direct operating costs arising from investing in property.	It is necessary to report, in particular, the classification of biological assets and data relating to the measurement at fair value (profit/loss arising from changes in the fair value, changes in the value of biological assets at the beginning and end of the current period et seq.).

Source: author´s own elaboration according to [3, 7], 2013.

Having compared the two tables, it is clear that the policies concerning the measurement and recognition of non-current assets according to the IFRS for SMEs are not entirely consistent with those recommended by the individual standards of IAS/IFRS. Therefore, hypothesis 1 can be confirmed: the entity would have to adjust its financial reporting when switching from the IFRS for SMEs accounting system to the IAS/IFRS for the first time.

This fact is particularly caused by the possibility to choose a revaluation model for measurement at the end of balance-sheet date for tangible assets held for production, supply of goods or services, and for administrative purposes and also for assets held for investment purposes. The choice of valuation model undoubtedly contributes to the true and fair presentation of assets. However, it is necessary to point out to the fact that the IAS/IFRS conceptual framework regulating the basic policies of financial reporting and also the section of Concepts in the IFRS for SMEs (similar to the IAS/IFRS Framework) are based on the principle of materiality. Thus, if the volume of tangible fixed assets did not exceed the limit of materiality set by the entity itself, a different measurement base would probably not impair the true and fair view of reality. The issues of assets measurement are further dealt with in paper [12], the objective of this article is to point out the significant differences in the area of measurement of assets according to IAS 16 Property, plant and equipment in financial statements prepared under International Financial Reporting Standards (IFRS). The paper [2] on fair value is also valuable for this topic. "In this paper is attempted an empirical research on the perception of accounting practitioners over an accounting system based on fair value. Through the empirical research activity is aimed to determine and analyze the options and prospects for applying various valuation bases within an accounting system, taking into account the fact that the international accounting regulations display an ever increasing interest for valuations based on fair value.

Another paper [11], characterizing the accounting reform in Romania, deals with the concrete impact of measurement in the accounting system.

When comparing the IFRS for SMEs and IAS/IFRS, differences in the scope of disclosure duties have also been found. On the other hand, the smallest differences can be identified in the measurement at recognition and in depreciation.

Within the differences of the IFRS for SMEs from the full version of IAS/IFRS there is thus room for a discussion whether the standard intended primarily for small and medium-sized entities should offer within the measurement bases the same options of measurement models as IAS 16 and IAS 40 standards, particularly due to the comparability of companies of different sizes and also due to the comparability of company´s financial statements prepared at the time of the IFRS for SMEs´ adoption and after the transition to the IAS/IFRS.

3.2. Empirical research into the implementation of the IFRS for SMEs and IAS/IFRS in the Czech Republic

To verify the second hypothesis defined, it is necessary to present the results of the research that has been defined in the methodology chapter. Due to the extent of the questionnaire survey, only findings from the separate questionnaire part focused on the implementation of the IAS/IFRS and the IFRS for SMEs are presented.

When asked whether the respondent had previously met with the accounting system of IAS/IFRS or IFRS for SMEs, the majority of respondents (53.8%) answered that they had heard of it but could not define the main differences from the financial reporting according to the legal regulations of the Czech Republic. Only 11 respondents (10.6%) had received training either directly focused on or at least marginally involving financial reporting according to the International Financial Reporting Standards.

What seems to be interesting is a finding of the authors that controlling staff of large companies in particular (not included in the survey) also have the knowledge of IAS/IFRS, because they are competent to carry out an analysis of economic activities for the parent company.

The results of research into the knowledge of the IAS/IFRS or IFRS for SMEs accounting systems are shown in the following chart:
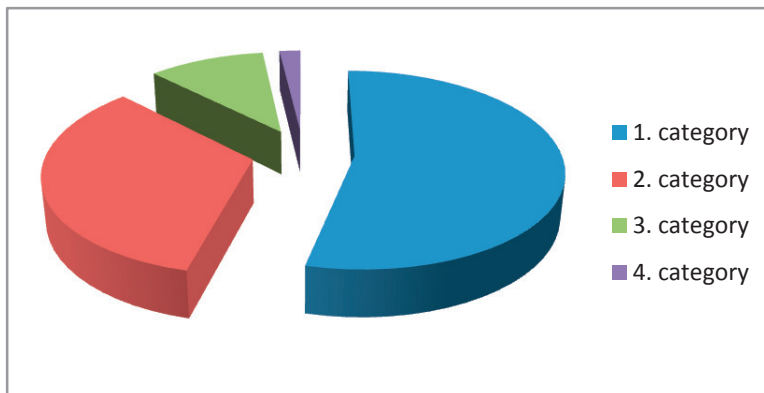

Fig. 1. Percentage distribution of the accounting staff of small and medium-sized entities in the CR according to the knowledge of IAS/IFRS or IFRS for SMEs, Source: Auhor´s own elaboration, 2012.

The pie chart shows the distribution of accounting professionals from small and medium-sized entities in the Czech Republic:

Category I (56 respondents) = they have already heard of the IAS/IFRS and IFRS for SMEs accounting systems; however, they cannot define the main differences from the accounting according to the legal regulations of the CR,

Category II (35 respondents) = they have read about the IAS/IFRS and IFRS for SMEs, can define several main differences from the accounting according to the legal regulations of the CR (the stated differences were especially those in partial accounting principles, measurement bases, true and fair presentation, the format of statements, etc.)

Category III (11 respondents) = they completed the training. One respondent studied the issues of IAS/IFRS within his/her university studies.

Category IV (2 respondents) = they applied the IAS/IFRS or IFRS for SMEs in practice.

Based on the results of the above survey, it is logical that the questions of whether the IAS/IFRS or IFRS for SMEs financial reporting would provide users with better information about business activities, or what benefits the use of IAS/IFRS, or more precisely IFRS for SMEs, would have were answered by the respondents in two ways:

The first group of respondents (without greater knowledge of IAS/IFRS) said that they could not imagine any benefits or more precisely any particular improvements yet. The same vague answer was given to the question of whether there was a real possibility to apply the IAS/IFRS or IFRS for SMEs in their company. They answered either directly no, or not under the current legislative conditions.

The second group of respondents, in which the authors included also respondents already using the IAS/IFRS and respondents with a deeper knowledge of IAS/IFRS or IFRS for SMEs, identified the benefits of this system as:

• providing high-quality, transparent and comparable information for financial analysts,
• clearer and more realistic accounting information for decision-making of internal users.

However, these respondents put the benefits stated above into the context of the necessity to invest in the training and development of employees in the accounting area and also pointed to the fact that the profit or loss according to the IAS/IFRS or IFRS for SMEs would, in most cases, show lower values.

When considering the fact whether the respondents in small and medium-sized entities have sufficient knowledge of the IAS/IFRS and IFRS for SMEs, or not, it is also necessary to take into account the fact that only the profit or loss determined according to the Czech accounting standards (this is further adjusted by tax law) can be used to calculate income tax in the Czech Republic. In the event that small and medium-sized enterprises prepared financial statements according to the IFRS for SMEs, they would still have to (to some extent duplicately) keep the books and prepare the financial statements according to the legal regulations of the Czech Republic to be able to calculate the profit or loss and correctly calculate the taxable income. Reporting of financial data both according to the legal regulations of the Czech Republic and according to IFRS for SMEs is, for enterprises of this size, very administrative-intensive, so the International Financial Reporting Standard for SMEs is not applied in the Czech Republic by small and medium-sized enterprises.

It is obvious from the above-mentioned results of the questionnaire survey that hypothesis 2 cannot be confirmed or disproved unequivocally. Although the overall majority of respondents did not have active knowledge of the IAS/IFRS and IFRS for SMEs, it was only a slight superiority represented by 53.8% of accounting professionals. However, in the basic sample of respondents there is a strong group of respondents (33.6%) that have conceptual knowledge of these systems and can define at least several main differences when contrasting it with the accounting system according to the legal regulations of the Czech Republic.

3.3. Proposal for further research

The above presented research findings showed that economists respectively Chief Accountant in most cases do not have an active knowledge of IFRS for SMEs. It is also possible to infer that the state of awareness of the IFRS for SMEs in common (ordinary) accounting staff will be even worse. Therefore it would be appropriate for further research to determine the real possibility of staff training and quantify the costs of training common (ordinary) accounting staff with determining whether the amount of such costs for businesses was significant or not.

4. Conclusion

Tangible fixed assets are an important part of the corporate assets of most business entities, regardless of their size or forms of business. The paper compared the policies for measurement, depreciation, and recognition of tangible fixed assets according to the wording of the IAS/IFRS and IFRS for SMEs. Differences were found especially in the subsequent measurement of assets as at the balance sheet date, because IAS 16 and IAS 40 allow a choice between the cost model and the fair value model. This finding led to the confirmation of the first defined hypothesis.

Furthermore, the paper presented the results of the questionnaire survey which, on the sample of 104 respondents, confirmed that there is a slightly bigger group of economists from small and medium-sized enterprises who do not have active knowledge of the IAS/IFRS and IFRS for SMEs accounting systems. Due to the slight superiority of this group, Hypothesis 2, claiming that the vast majority of small and medium-sized enterprises are not at all informed of the international accounting standards and therefore they are unable to define their contribution to financial reporting, cannot be accepted unequivocally.

References

[1] Breuer, A.; LesconiFrumusanu, N. M.; Lighezan Breuer, B. G. &Jurchescu, M. D. International Accounting Harmonization and Normalization: Case Study – Case of Romania. Annals of DAAAM for 2010 & Proceedings of the 21st International DAAAM Symposium, Volume 21, No. 1, ISSN 1726-9679.

[2] CozmaIghian, D. S.: Empirical Study on the Prospects of Applying Fair Value Accounting in Romania. Annals of DAAAM for 2010 & Proceedings of the 21st International DAAAM Symposium, Volume 21, No. 1, ISSN 1726-9679.

[3] Epstein, B.J., Jermakowicz, E.K. IFRS 2009: Implementation and Application of International Financial Reporting Standards. New Jersey: John Wiley & Sons, 2009. ISBN: 978-0470-28609-8

[4] European Parliament and of the Council [online]. Brusel: Summaries of EU legislative: REGULATION (EC) No 1606/2002 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 July 2002 on the application of international accounting standards. 2010 [cit. 2010-11-22]. Retrieved from www: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri= OJ:L:2002:243:0001: 0004: EN:PDF.

[5] Hinke, J., Hrdý, M.: The Information Ability of the Accounting Statements of the Small and Medium Enterprises in the Czech Republic and the Possibility of their Improvement with the Help of the Questionnaire Research. Českýfinančníaúčetníčasopis, Number 3/2012, ISSN 1802-2200.

[6] Horová, M. Performance Audit Considering the Sustainability: Approach of the Czech Enterprises, in: Proceedings of the 8th European Conference on Management, Leadership and Governance, Academic Publishing International Limited, Reading, 2012, pp. 231-236.

[7] IASB, International Accounting Standards Board. International Financial Reporting Standards 2012. London: IFRS Foundation Publications Department, 2012. ISBN 978-1-907877-45-2.

[8] IASB, International Accounting Standard Board. International Financial Reporting Standard for Small and Medium-sized Entities.2009 [On-line]. Available: http://www.ifrs.org/IFRS-for-SMEs/Pages/IFRS-for-SMEs.aspx [Accessed: 28 Apr. 2013]

[9] Kynclová, D.: Method of Converting Accounting Data for Tax Purposes in Relation to Long-term Tangible Property. Český finanční a účetní časopis, Number 3/2012, ISSN 1802-2200.

[10] Lewis Lawrence D. The Power of Accounting. New York: Routledge, 2012. ISBN 978-0-415-88430-3.

[11] Man, M.; Macris, M. &Ravas, B.: The Accounting Reform in Romania – Normalization and Regulation. Annals of DAAAM for 2010 & Proceedings of the 21st International DAAAM Symposium, Volume 21, No. 1, ISSN 1726-9679.

[12] Talnagiova, V. &Cerna, L.: Measurement of Assets in Financial Statements of an Industrial Company. Annals of DAAAM for 2011 & Proceedings of the 22nd International DAAAM Symposium, Volume 22, No. 1, ISSN 1726-9679