



March 2018

# Financial Reporting Framework for Small- and Medium-Sized Entities

## Comparisons of the FRF for SMEs™ Reporting Framework to Other Bases of Accounting



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## Introduction

Owner-managers of SMEs, CPAs serving SMEs, users of SME financial statements, and other stakeholders are often familiar with the tax basis of accounting and U.S. GAAP. Also, many stakeholders are following the implementation of the International Financial Reporting Standard for Small- and Medium-Sized Entities (IFRS for SMEs) around the world as its use continues to expand and its implications for the U.S. marketplace continue to grow. As such, these stakeholders are interested in understanding how the principles and criteria included in the FRF for SMEs accounting framework compare to those other bases of accounting.

To assist those stakeholders, comparisons of the FRF for SMEs accounting framework to (1) the tax basis, (2) U.S. GAAP, and (3) IFRS for SMEs are presented on the following pages. These comparisons are not all inclusive. Rather, the following comparisons are made at a high level and are intended to draw attention to differences between the FRF for SMEs accounting framework and the other bases of accounting on certain accounting and financial reporting matters.

## Comparison of the FRF for SMEs Accounting Framework With Tax Basis Accounting (March 2018)

The FRF for SMEs accounting framework draws upon a blend of traditional methods of accounting and accrual income tax accounting. One of its key features is that adjustments needed to reconcile tax return income with book income are reduced. The following is a comparative discussion of the FRF for SMEs accounting framework and tax basis accounting for certain topics considered significant for most users of the framework. This presentation does not describe all of the differences between the FRF for SMEs accounting framework and the tax basis of accounting. Rather, the presentation highlights areas that AICPA staff believes would be of particular interest to stakeholders.

### *Overview of Tax Basis Financial Statements*

The *tax basis* is defined as "a basis of accounting that the entity uses to file its income tax return for the period covered by the financial statements." It is typically based on federal income tax laws found in the Internal Revenue Code (IRC), along with related regulations, revenue rulings, and procedures. These laws and regulations generally deal with the determination of taxable income and, therefore, focus on the measurement of revenues and expenses (and in some cases, on the determination of the basis of assets and liabilities). However, income tax laws generally do not address financial statement presentation or disclosure considerations.

### *IRS Accounting Methods*

The tax basis of accounting covers a range of alternative bases, from cash to full accrual, depending on the nature of the reporting entity and, in some cases, the entity's elections. In general, the IRC allows two overall methods of accounting: the cash method and the accrual method.

- Under the cash method (used by many small businesses)
  - income includes all items actually or constructively received during the year, and
  - expenses are generally deducted in the year they are actually paid or the property is transferred.
- Under the accrual method
  - income is generally reported in the year earned.
  - expenses are generally deducted in the year incurred.
  - generally, the IRC requires that businesses that use inventories (they produce or purchase merchandise and sell it to produce income) use the accrual method for inventory purchases and sales.

Entities may select an accounting method based on the following rules.

<p>C Corporations</p>	<ul style="list-style-type: none"> <li>• Generally, C corporations are required to use the accrual method of accounting.</li> <li>• Exceptions allowing the use of the cash method:             <ul style="list-style-type: none"> <li>• The corporation's average gross receipts are \$25 million or less for the prior 3 years.</li> <li>• The IRC allows qualified personal service corporations to use the cash method.</li> <li>• The accrual method does not apply to farming businesses.</li> </ul> </li> </ul>
<p>S Corporations</p>	<ul style="list-style-type: none"> <li>• S corporations generally are eligible to use either the cash or accrual.</li> <li>• However, S corporations that allocate more than 35% of their losses to shareholders who do not actively participate in the management of the business cannot use the cash method.</li> </ul>
<p>Partnerships</p>	<ul style="list-style-type: none"> <li>• Partnerships are generally eligible to use either cash or accrual.</li> <li>• Limitations on use of the cash method:             <ul style="list-style-type: none"> <li>• Generally, limited partnerships that allocate more than 35% of their tax losses to limited partners cannot use the cash method.</li> <li>• If general or limited partnerships have C corporation partners, they cannot use the cash method if the partnerships have average gross receipts of more than \$25 million for the three preceding tax years.</li> </ul> </li> </ul>
<p>Sole Proprietorships</p>	<ul style="list-style-type: none"> <li>• Generally, sole proprietorships are eligible to use either cash or accrual.</li> <li>• A sole proprietor may use the accrual method for the business and the cash method for nonbusiness income and deductions.</li> <li>• Accrual method is required when inventory is an integral component of their business unless the business is a qualifying sole proprietorship.             <ul style="list-style-type: none"> <li>• A qualifying sole proprietor must:                 <ul style="list-style-type: none"> <li>• Have average annual gross receipts for the past 3 taxable years of \$25 million or less</li> <li>• Not be a tax shelter</li> </ul> </li> </ul> </li> </ul>

## Key Differences Between the FRF for SMEs Accounting Framework and the Tax Basis of Accounting

Although the FRF for SMEs accounting framework largely parallels the accrual method under the tax basis of accounting, the FRF for SMEs reporting option provides a more comprehensive and consistent financial reporting and accounting basis than the tax basis. This leads to a more complete presentation of the entity's financial position, results of operations, and cash flows, as well as more informative disclosures.

### Revenue and Expense Recognition

Generally, revenue and expense recognition does not differ between the FRF for SMEs accounting framework and the accrual method for income tax reporting purposes.

Revenue	<p>Under the tax basis, income is generally reported in the year earned.</p> <ul style="list-style-type: none"><li>• Entities using the tax basis generally include an amount as gross income for the tax year in which<ul style="list-style-type: none"><li>— all events that fix the entity's right to receive the amount have occurred, and</li><li>— the entity can determine the amount with reasonable accuracy.</li></ul></li></ul> <p>Under this rule, an amount is included in gross income on the earliest of the following dates:</p> <ul style="list-style-type: none"><li>• When payment is received</li><li>• When the income amount is due to the entity</li><li>• When the income is earned</li></ul>
Expenses	<p>Expenses are generally deducted or capitalized when all of the following conditions are met:</p> <ul style="list-style-type: none"><li>• All events necessary to establish the fact of liability or deduction have occurred.</li><li>• The amount of the liability or deduction is determinable with reasonable accuracy.</li><li>• Economic performance has occurred.<ul style="list-style-type: none"><li>— Generally, economic performance occurs when property or services are provided to (or by) another party, or when the property is used.</li></ul></li></ul>

## Special Revenue Situations

As stated previously, generally, revenue recognition does not differ between the FRF for SMEs accounting framework and the accrual method for income tax reporting purposes. However, special rules may apply to the following.

Topic	FRF for SMEs Accounting Framework	Tax Basis
Installment Sales	<ul style="list-style-type: none"> <li>Revenue is ordinarily recognized at the time a sale is made, even if the sales price will be collected in installments.</li> </ul>	<ul style="list-style-type: none"> <li>Income from an installment sale is recognized when it is fixed and determinable and all events have occurred.</li> <li>Deductions are permitted later if the sale becomes uncollectible.</li> </ul>
Sales Returns	<ul style="list-style-type: none"> <li>Recognition of probable returns in the period the sale is recognized.</li> </ul>	<ul style="list-style-type: none"> <li>No allowance for returns is permitted—returns cannot be recorded until they occur.</li> </ul>
Advance Payments	<ul style="list-style-type: none"> <li>Advance payments are generally recorded as deferred revenue and recognized when earned.</li> </ul>	<ul style="list-style-type: none"> <li>Advance payments for services to be performed in a later tax year are generally recognized as income in the year the payment is received.</li> <li>However, if the services are to be performed by the end of the next tax year, the entity can elect to postpone recognizing the advance payment until the next tax year.</li> </ul>
Long-Term Contracts	<ul style="list-style-type: none"> <li>Performance should be determined using one of the following methods:               <ul style="list-style-type: none"> <li>Percentage-of-completion method</li> <li>Completed-contract method                   <ul style="list-style-type: none"> <li>Used when the entity cannot reasonably estimate the extent of progress toward completion</li> <li>May also be used if the following conditions are met:</li> </ul> </li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Generally, entities must report earnings from long-term contracts for tax purposes using the percentage-of-completion method.</li> <li>However, entities with average gross receipts of \$25 million or less for the 3 taxable years preceding the contract year and that perform only real property contracts that will be completed within 2 years or manufacturing contracts that will be completed within 1 year may use the completed-contract method.</li> </ul>

Topic	FRF for SMEs Accounting Framework	Tax Basis
Long-Term Contracts (Continued)	<ul style="list-style-type: none"> <li>— The completed contract method is used for income tax reporting purposes.</li> <li>— The financial position and results of operations of the entity would not vary materially from those resulting from use of the percentage-of-completion method (for example, in circumstances in which an entity has primarily short-term contracts).</li> </ul>	
Rental Income and Expense	<ul style="list-style-type: none"> <li>• Lessees and lessors generally recognize rent under noncancelable operating leases on a straight-line method over the period the lessee controls the use of the leased property.</li> </ul>	<ul style="list-style-type: none"> <li>• Accrual method lessors usually recognize rental income under operating leases when earned.</li> <li>• Accrual method lessees generally recognize rent expense under operating leases when payments are due.</li> </ul>



Statement of Financial Position Measurement and Presentation Issues

Topic	FRF for SMEs Accounting Framework	Tax Basis
Receivables	<ul style="list-style-type: none"> <li>Allows entities to provide an allowance for receivables for which collection is doubtful.</li> </ul>	<ul style="list-style-type: none"> <li>Must use the specific charge-off method to deduct bad debt losses related to trade notes and accounts receivable. Receivables are not charged to expense until all collection efforts have been exhausted and they are deemed worthless.</li> </ul>
Inventories	<ul style="list-style-type: none"> <li>Inventory is measured at the lower of cost or net realizable value.</li> <li>Cost is determined by any of the conventional cost flow assumptions.</li> <li>Charging all overhead costs to expense is not permitted.</li> <li>Abnormal amounts of production costs, wasted materials, and labor are to be charged to expense in the year they are incurred.</li> <li>Overhead costs are allocated based on normal production capacity. This might create differences between inventory calculated under the framework and under tax laws.</li> <li>Inventory losses are essentially recorded when they are probable and estimable, whether they result from obsolescence, damage, or declining prices.</li> </ul>	<ul style="list-style-type: none"> <li>Inventory is generally valued using the cost method, lower of cost or market method, or retail method.</li> <li>Cost is determined by any of the conventional cost flow assumptions.</li> <li>Charging all overhead costs to expense is not permitted.</li> <li>Inventory losses are generally not recognized until the inventory is actually offered for sale at lower prices or until the inventory is actually sold or discarded.</li> <li>Taxpayers meeting the \$25 million gross receipts test are not required to account for inventories under section 471 and may use a method that:               <ul style="list-style-type: none"> <li>Treats inventories as non-incidental materials and supplies, or</li> <li>Conforms to the financial accounting treatment of inventories.</li> </ul> </li> </ul>
Investments	<ul style="list-style-type: none"> <li>Equity and debt instruments held for sale are accounted for at market value, which results in unrealized gains and losses being recognized in some cases.</li> </ul>	<ul style="list-style-type: none"> <li>In general, investments in debt and equity securities are carried at cost for income tax reporting purposes. Accordingly, gains and losses under the income tax basis generally are recognized only when realized.</li> </ul>



Topic	FRF for SMEs Accounting Framework	Tax Basis
Investments (Continued)	<ul style="list-style-type: none"> <li>The equity method is used to account for investments when the investor can exercise significant influence over the investee. Generally, significant influence exists when the ownership interest is 20% or more.</li> </ul>	<ul style="list-style-type: none"> <li>For tax purposes, the equity method of accounting does not exist. Instead, dividend income is included in income.</li> <li>A pro rata share of the investee income or loss is not recorded by the investor.</li> </ul>
Prepaid Expenses	<ul style="list-style-type: none"> <li>Recorded as an asset and amortized to expense.</li> </ul>	<ul style="list-style-type: none"> <li>Expenses paid in advance are deductible only in the year to which the expense applies, unless the expense qualifies for the "12-month rule."</li> <li>Under the 12-month rule, the entity is not required to capitalize amounts paid to create certain rights or benefits that do not extend beyond the earlier of the following: <ul style="list-style-type: none"> <li>12 months after the right or benefit begins</li> <li>The end of the tax year after the tax year in which payment is made</li> </ul> </li> </ul>
Property and Equipment	<ul style="list-style-type: none"> <li>Requires depreciation to be recognized in a rational and systematic manner over the useful life of the asset. Depreciation expense is calculated on the cost less any expected <i>residual value</i>.</li> <li>Assets contributed by an owner are valued at market value.</li> <li>Does not recognize an expense similar to the IRC Section 179 deduction for costs incurred to acquire certain property and equipment during the year within specified limitations.</li> </ul>	<ul style="list-style-type: none"> <li>Most property and equipment is depreciated under the Modified Accelerated Cost Recovery System, often resulting in more rapid depreciation over shorter lives than would be used under the FRF for SMEs accounting framework.</li> <li>Internal Revenue Code (IRC) Section 179 permits taxpayers to deduct the cost incurred to acquire certain property and equipment during the year within specified limitations.</li> <li>Assets contributed by an owner may be valued at the owner's tax basis.</li> </ul>

Topic	FRF for SMEs Accounting Framework	Tax Basis
Property and Equipment (Continued)		<ul style="list-style-type: none"> <li>• Tax laws pertaining to capital leases are less explicit than under the FRF for SMEs accounting framework. Generally, for tax purposes, an equipment lease is not considered to be a capital lease unless it contains a bargain-purchase option.</li> </ul>
Intangible Assets	<ul style="list-style-type: none"> <li>• Goodwill is amortized over a 15-year period.</li> <li>• A recognized intangible asset is amortized over the best estimate of its useful life.</li> </ul>	<ul style="list-style-type: none"> <li>• Intangible assets (including goodwill) acquired after August 10, 1993 (or July 25, 1991, if elected), are referred to as IRC Section 197 intangibles and may be amortized over a 15-year life beginning with the month the assets were acquired.</li> </ul>
Consolidation	<ul style="list-style-type: none"> <li>• Consolidation is based on a threshold of more than 50% ownership.</li> <li>• The framework provides more explicit guidance on accounting for a business combination, as well as subsequent consolidation.</li> </ul>	<ul style="list-style-type: none"> <li>• The threshold for consolidation under the IRC is 80% ownership.</li> </ul>

## Comparison of the FRF for SMEs Accounting Framework With U.S. GAAP—Major Areas (November 2017)

The following table presents a high-level comparison of the FRF for SMEs accounting framework with U.S. GAAP for certain key topics. This presentation does not describe all of the differences between the FRF for SMEs accounting framework and U.S. GAAP. Rather, the presentation highlights areas that AICPA staff believes would be of particular interest to stakeholders.

The Private Company Council (PCC) advises the FASB on accounting treatment for private companies for items on the FASB's technical agenda and on possible alternatives within GAAP for the needs of the users of private company financial statements. Any proposed changes to GAAP are subject to endorsement by the FASB. These alternatives have been noted under the applicable topic.

Topic	FRF for SMEs Accounting Framework	U.S. GAAP
Fair Value	<ul style="list-style-type: none"> <li>• Uses the term <i>market value</i>. It is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act."</li> <li>• Market value measurement used only in very limited circumstances, such as business combinations, certain nonmonetary transactions, and marketable equity and debt securities that are held for sale.</li> </ul>	<ul style="list-style-type: none"> <li>• <i>Fair value</i> is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."</li> <li>• Provides an overall framework to measuring fair value (for example, fair value hierarchy, valuation techniques).</li> <li>• Standardized disclosure requirements for fair value measurements.</li> <li>• Nonpublic entities are exempt from certain fair value disclosures.</li> </ul>
Going Concern	<ul style="list-style-type: none"> <li>• Requires management assessment of whether the going concern basis of accounting is appropriate.</li> <li>• When management becomes aware of material uncertainties relating to events or conditions and concludes that a known event or condition is probable of having a severe impact on the entity's ability to realize its assets and discharge its liabilities in the ordinary course of business, the entity should disclose those uncertainties along with its plans for dealing with the adverse effects of the conditions and events.</li> </ul>	<ul style="list-style-type: none"> <li>• Management is required to assess if the going concern basis of accounting is appropriate. Disclosures should address management's assessment and plan to deal with the effects of conditions and events.</li> </ul>

Topic	FRF for SMEs Accounting Framework	U.S. GAAP
Impairment	<ul style="list-style-type: none"> <li>No assessment of impairments for long-lived assets.</li> <li>A depreciated or amortized cost approach is followed. Assets no longer used are written off.</li> </ul>	<ul style="list-style-type: none"> <li>Long-lived assets are tested for impairment upon a triggering event.</li> <li>Goodwill and indefinite-lived intangible assets are subject to an impairment test annually. An impairment test is also required upon a triggering event. Optional qualitative assessment is permitted (Step 0)</li> <li><b>PCC Alternative:</b> An entity may elect to amortize goodwill on a straight-line basis for the lesser of 10 years or the useful life. An impairment test should be performed when a triggering event occurs which indicates the fair value of an entity may be below the carrying amount.</li> </ul>
Comprehensive Income	<ul style="list-style-type: none"> <li>No concept of comprehensive income or items of other comprehensive income (OCI).</li> </ul>	<ul style="list-style-type: none"> <li>Certain items are classified as OCI and displayed as such.</li> </ul>
Industry-Specific Guidance	<ul style="list-style-type: none"> <li>Framework does not contain industry-specific guidance.</li> </ul>	<ul style="list-style-type: none"> <li>Extensive industry-specific guidance.</li> <li>See the revenue recognition section below for major changes in GAAP.</li> </ul>
Consolidation/ Subsidiaries	<ul style="list-style-type: none"> <li>Policy choice to either consolidate subsidiaries or account for subsidiaries using the equity method.</li> <li><i>Subsidiary</i> defined as an entity in which another entity owns more than 50% of the outstanding residual equity interests.</li> <li>No concept of variable interest entities (VIEs).</li> </ul>	<ul style="list-style-type: none"> <li>Consolidation is required for reporting entity with controlling financial interest in another entity.</li> <li>VIE model is used when controlling financial interest is achieved through arrangements that do not involve voting interests.</li> </ul> <p><b>PCC Alternative:</b> Permits a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity under certain conditions. <sup>Fn1</sup></p>
Income Taxes	<ul style="list-style-type: none"> <li>Policy choice to account for income taxes using either the taxes payable</li> </ul>	<ul style="list-style-type: none"> <li>Income taxes accounted for using a deferred income tax method.</li> </ul>

Topic	FRF for SMEs Accounting Framework	U.S. GAAP
Income Taxes (Continued)	<p>method or the deferred income taxes method.</p> <ul style="list-style-type: none"> <li>No evaluation or accrual of uncertain tax positions.</li> </ul>	<ul style="list-style-type: none"> <li>Uncertain income tax positions must be evaluated and accrual made if certain conditions are met.</li> </ul>
Leases	<ul style="list-style-type: none"> <li>Traditional accounting approach blended with some accrual income tax accounting methods.</li> <li>Lessee classifies leases as either operating or capital leases.</li> <li>Lessor accounts for leases as sales type, direct financing, or operating.</li> </ul>	<p>Extant GAAP:</p> <ul style="list-style-type: none"> <li>Lessee classifies leases as either operating or capital leases.</li> <li>Lessor accounts for leases as sales type, direct financing, or operating.</li> </ul> <p>Prospective GAAP:</p> <ul style="list-style-type: none"> <li>Following the effective date of 12/15/19 for ASU 2016-02, leases will be as follows:</li> <li>Lessee accounting: <ul style="list-style-type: none"> <li>Balance sheet: Gross asset and liability reported on balance sheet. (Election not to report for terms of 12 months or less)</li> <li>Income statement: Historical categorization still relevant for financing and operating type leases</li> </ul> </li> <li>Lessor accounting: <ul style="list-style-type: none"> <li>Lease classification as financing or a sale</li> </ul> </li> </ul>
Push-Down Accounting	<ul style="list-style-type: none"> <li>New basis (push-down) accounting guidance provided.</li> </ul>	<ul style="list-style-type: none"> <li>No requirement to apply push-down accounting. An acquired entity may elect to apply pushdown accounting</li> </ul>

<sup>fn1</sup> Under the proposed amendments, a private company (reporting entity) would not have to apply VIE guidance to legal entities under common control (including common control leasing arrangements) if both the parent and the legal entity being evaluated for consolidation are not public business entities.

Topic	FRF for SMEs Accounting Framework	U.S. GAAP
Push-Down Accounting (Continued)	<ul style="list-style-type: none"> <li>Specific guidance provided on comprehensive revaluation of assets and liabilities under certain conditions.</li> </ul>	upon change of control event occurring.
Intangible Assets	<ul style="list-style-type: none"> <li>All intangible assets are considered to have a finite useful life and are amortized over their estimated useful lives.</li> <li>In accounting for expenditures on internally-generated intangible assets during the development phase, management should make an accounting policy choice to either expense such expenditures as incurred or capitalize such expenditures as an intangible asset, provided the criteria are met.</li> </ul>	<ul style="list-style-type: none"> <li>A recognized intangible asset is amortized over its useful life unless that life is determined to be indefinite.</li> <li>Intangible assets subject to amortization are tested for impairment upon a triggering event.</li> <li>Indefinite-lived intangible assets are subject to an impairment test annually. An impairment test is also required upon a triggering event. Optional qualitative assessment is permitted.</li> </ul>
Goodwill	<ul style="list-style-type: none"> <li>Amortized over the same period as that used for federal income tax purposes or 15 years.</li> <li>No impairment testing.</li> </ul>	<ul style="list-style-type: none"> <li>No amortization.</li> <li>Tested for impairment at least annually.</li> <li>An impairment test is also required upon a triggering event. Optional qualitative assessment is permitted (Step 0).</li> <li><b>PCC Alternative:</b> An entity may elect to amortize goodwill on a straight-line basis for the lesser of 10 years or the useful life. An impairment test should be performed when a triggering event occurs which indicates the fair value of an entity may be below the carrying amount.</li> </ul>
Revenue	<ul style="list-style-type: none"> <li>Broad, principle-based guidance on revenue recognition.</li> </ul>	<ul style="list-style-type: none"> <li>The FASB's new revenue recognition standard is a broad principles-based revenue recognition model that fundamentally changes the approach</li> </ul>

Topic	FRF for SMEs Accounting Framework	U.S. GAAP
Revenue (Continued)	<ul style="list-style-type: none"> <li>Revenue should be recognized when performance is achieved and ultimate collection is reasonably assured.</li> <li>For goods: Performance is achieved when the entity transfers the risks and rewards associated with the goods to a customer.</li> <li>For services: Performance should be determined using either the percentage of completion method or the completed contract method. Performance should be regarded as having been achieved when reasonable assurance exists regarding the measurement of the consideration that will be derived from rendering the service or performing the long-term contract.</li> </ul>	<p>to accounting for revenue (and it replaces industry-specific revenue guidance). The effective date for this standard is December 15, 2017 for public companies and December 15, 2018 for private companies.</p> <ul style="list-style-type: none"> <li>AICPA has a revenue recognition guide to assist preparers and auditors implement the standard in many industries.</li> </ul>
Investments/ Financial Assets and Liabilities	<ul style="list-style-type: none"> <li>Historical cost approach.</li> <li>Market value measurement required only for investments being held for sale.</li> <li>Changes in market value included in net income.</li> </ul>	<ul style="list-style-type: none"> <li>Classification required based on management intent and ability.</li> <li>Securities classified as "available for sale" or "trading" measured at fair value.</li> <li>Debt securities classified as "held-to-maturity" measured at amortized cost.</li> <li>Accounting for changes in fair value depends upon classification.</li> </ul>
Derivatives	<ul style="list-style-type: none"> <li>Disclosure approach.</li> <li>Recognition at settlement (cash basis).</li> <li>No hedge accounting.</li> </ul>	<ul style="list-style-type: none"> <li>Generally, derivatives are recognized as either assets or liabilities.</li> <li>Accounting for changes in fair value depends on the use of the derivative.</li> <li>Hedge accounting permitted.</li> </ul>



Topic	FRF for SMEs Accounting Framework	U.S. GAAP
Derivatives (Continued)		<ul style="list-style-type: none"> <li>• <b>PCC Alternative:</b> If certain criteria are met, interest rate swaps may have variable rate borrowing converted to a fixed rate borrowing.</li> <li>• Measure at fair value.</li> </ul>
Stock-Based Compensation	<ul style="list-style-type: none"> <li>• Disclosure only.</li> </ul>	<ul style="list-style-type: none"> <li>• Stock-based compensation is reported on the balance sheet and income statement.</li> </ul>
Defined Benefit Plans	<ul style="list-style-type: none"> <li>• Policy choice to account for plans using either a current contribution payable method or one of the accrued benefit obligation methods.</li> </ul>	<ul style="list-style-type: none"> <li>• Plans accounted for using a projected benefit obligation model.</li> </ul>
Business Combinations	<ul style="list-style-type: none"> <li>• As of the acquisition date, the acquirer should recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. Identifiable assets acquired and liabilities assumed are measured at their acquisition-date market values. Certain exceptions exist.</li> <li>• An entity should make an accounting policy choice to account for an intangible asset acquired in a business combination either by separately recognizing the intangible asset as an identifiable asset or by not separately recognizing the intangible asset as an identifiable asset and subsuming into goodwill the value of the intangible asset.</li> </ul>	<ul style="list-style-type: none"> <li>• As of the acquisition date, the acquirer should recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. Identifiable assets acquired and liabilities assumed are measured at their acquisition-date fair values. Certain exceptions exist.</li> <li>• <b>PCC Alternative:</b> An entity may recognize the fair value of intangible assets with goodwill if they are noncompetition agreements or customer-related intangibles incapable of being sold or licensed independently from other assets.</li> </ul>
Inventories	<ul style="list-style-type: none"> <li>• Valued at lower of cost or net realizable value.</li> </ul>	<ul style="list-style-type: none"> <li>• Valued at lower of cost or net realizable value.</li> </ul>

## Comparison of the FRF for SMEs Accounting Framework With IFRS for SMEs—Major Areas (November 2017)

In general, the FRF for SMEs reporting option is similar in many ways to IFRS for SMEs. Both are intended to be simplified, relevant, and cost-effective financial reporting frameworks for SMEs. In addition, both contain targeted financial statement disclosures and contain less prescriptive guidance. However, the IFRS for SMEs is GAAP whereas the FRF for SMEs reporting option is a special purpose framework. Also, the parameters defining what kinds of entities are intended to utilize the framework and IFRS for SMEs are different, with IFRS for SMEs having a more prescribed scope. The following table presents a high-level comparison of the FRF for SMEs accounting framework with IFRS for SMEs for certain key topics. This presentation does not describe all of the differences between the FRF for SMEs accounting framework and IFRS for SMEs. Rather, the presentation highlights areas that AICPA staff believes would be of particular interest to stakeholders.

Topic	FRF for SMEs Accounting Framework	IFRS for SMEs
Comparative Financial Statements	<ul style="list-style-type: none"> <li>Comparative financial statements are not required.</li> </ul>	<ul style="list-style-type: none"> <li>Requires comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements.</li> <li>An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.</li> </ul>
Comprehensive Income	<ul style="list-style-type: none"> <li>No concept of comprehensive income or items of other comprehensive income.</li> </ul>	<ul style="list-style-type: none"> <li>Provides an accounting policy choice between presenting total comprehensive income in a single statement or in two separate statements.</li> </ul>
Fair Value	<ul style="list-style-type: none"> <li>Uses the term <i>market value</i>. It is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act."</li> <li>Market value measurement used only in very limited circumstances, such as business combinations, certain nonmonetary transactions, and marketable equity and debt securities held-for-sale.</li> </ul>	<ul style="list-style-type: none"> <li>Use the term <i>fair value</i>. It is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.</li> <li>Wider use of fair value measurements compared to the FRF for SMEs accounting framework.</li> </ul>

Topic	FRF for SMEs Accounting Framework	IFRS for SMEs
Inventories	<ul style="list-style-type: none"> <li>• Last in, first out (LIFO) is permitted.</li> </ul>	<ul style="list-style-type: none"> <li>• LIFO is not permitted.</li> <li>• Inventory is assessed at the end of each reporting period for impairment or for recovery of previously recognized impairment.</li> </ul>
Property and Equipment	<ul style="list-style-type: none"> <li>• Requires depreciation to be recognized in a rational and systematic manner over the useful life of the asset. Depreciation expense is calculated on the cost less any expected <i>residual value</i>.</li> <li>• Assets contributed by an owner are valued at market value.</li> <li>• Does not recognize an expense similar to the IRC Section 179 deduction for costs incurred to acquire certain property and equipment during the year within specified limitations.</li> </ul>	<ul style="list-style-type: none"> <li>• Assets can be revalued after initial recognition.</li> </ul>
Subsidiaries	<ul style="list-style-type: none"> <li>• <i>Subsidiary</i> defined as an entity in which another entity owns more than 50% of the outstanding residual equity interests.</li> <li>• Policy choice to either consolidate subsidiaries or account for subsidiaries using the equity method.</li> <li>• No concept of special purpose entities (SPEs) or variable interest entities.</li> </ul>	<ul style="list-style-type: none"> <li>• <i>Subsidiary</i> defined as an entity that is controlled by the parent.</li> <li>• Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.</li> <li>• If an entity has created a SPE to accomplish a narrow and well-defined objective, the entity shall consolidate the SPE when the substance of the relationship indicates that the SPE is controlled by that entity.</li> </ul>
Investments/ Financial Assets and Liabilities	<ul style="list-style-type: none"> <li>• Historical cost approach for investments and financial assets and liabilities.</li> </ul>	<ul style="list-style-type: none"> <li>• There are two classification categories for financial instruments: amortized cost and fair value through earnings.</li> </ul>

Topic	FRF for SMEs Accounting Framework	IFRS for SMEs
Investments/ Financial Assets and Liabilities (Continued)	<ul style="list-style-type: none"> <li>Market value measurement required only for investments being held for sale, with changes in market value included in net income.</li> <li>Investees over which the investor has significant influence are accounted for under the equity method.</li> </ul>	<ul style="list-style-type: none"> <li>Basic financial instruments are measured at amortized cost except for investments in nonconvertible and nonputtable preference shares and nonputtable ordinary shares that are publicly traded or whose fair value can be measured reliably.</li> <li>All instruments other than basic debt instruments (including instruments with embedded derivatives) are measured at fair value through earnings.</li> <li>Investments in associates (<i>associates</i> are entities in which the investor has the ability to exercise significant influence) are accounted for using one of the following methods: the cost method (if there is no published price quotation), equity method, or fair-value-through-earnings method.</li> </ul>
Derivatives	<ul style="list-style-type: none"> <li>Disclosure approach.</li> <li>Recognition at settlement (cash basis).</li> <li>No hedge accounting.</li> </ul>	<ul style="list-style-type: none"> <li>Derivatives are recognized and measured at fair value through earnings.</li> <li>Hedge accounting prescribed.</li> </ul>
Stock-Based Compensation	<ul style="list-style-type: none"> <li>Disclosure only.</li> </ul>	<ul style="list-style-type: none"> <li>Compensation expense is recognized.</li> <li>Specific accounting depends on terms and type of instrument.</li> </ul>
Leases	<ul style="list-style-type: none"> <li>The criteria for determining whether a lease is a capital lease to a lessee generally are similar to IFRS for SMEs. Unlike IFRS for SMEs, however, the FRF for SMEs accounting framework provides specific quantitative thresholds for determining certain criteria.</li> </ul>	<ul style="list-style-type: none"> <li>See the FRF for SMEs Accounting Framework column.</li> </ul>

Topic	FRF for SMEs Accounting Framework	IFRS for SMEs
Leases (Continued)	<ul style="list-style-type: none"> <li>Under the FRF for SMEs accounting framework, if land is the sole item of property leased, the lessee accounts for the lease as a capital lease only if the lease transfers ownership of the property at the end of the lease term.</li> <li>From the point of view of a lessor, some additional criteria must be met to classify the lease as a capital lease.</li> <li>Under the FRF for SMEs accounting framework, lessors' capital leases are categorized as direct financing leases or sales-types leases (both similar to the finance lease category in IFRS for SMEs).</li> </ul>	
Goodwill	<ul style="list-style-type: none"> <li>Amortized over the same period as that used for federal income tax purposes or 15 years.</li> <li>No impairment testing.</li> </ul>	<ul style="list-style-type: none"> <li>Goodwill is amortized over its useful life. If an entity cannot reliably estimate its useful life, the life is presumed to be 10 years.</li> <li>Impairment testing is required only when there is an indicator of impairment.</li> </ul>
Intangible Assets	<ul style="list-style-type: none"> <li>All intangible assets are considered to have a finite useful life and are amortized over their estimated useful lives.</li> <li>In accounting for expenditures on internally-generated intangible assets during the development phase, management should make an accounting policy choice to either expense such expenditures as incurred or capitalize such expenditures as an intangible asset, provided the criteria are met.</li> </ul>	<ul style="list-style-type: none"> <li>All intangible assets (including goodwill) are finite-lived and are amortized over their useful lives. If an entity cannot reliably estimate the useful life of an intangible asset, the life is presumed to be 10 years.</li> <li>Expenditures on internally developed intangibles, including research and development costs, are expensed as incurred, unless they are part of the cost of another asset that meets the recognition criteria in IFRS for SMEs.</li> </ul>
Statement of Cash Flows	<ul style="list-style-type: none"> <li>Cash inflows from interest and dividends received should be classified as cash flows from operating activities.</li> </ul>	<ul style="list-style-type: none"> <li>An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss.</li> </ul>

Topic	FRF for SMEs Accounting Framework	IFRS for SMEs
Statement of Cash Flows (Continued)	<ul style="list-style-type: none"> <li>• Cash outflows related to interest paid should be classified as an operating activity, unless capitalized.</li> <li>• Cash outflows related to dividends paid should be classified as cash flows used in financing activities.</li> <li>• Cash outflows from dividends paid by subsidiaries to noncontrolling interests should be presented separately as cash flows used in financing activities.</li> </ul>	<ul style="list-style-type: none"> <li>• Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows, respectively, because they are costs of obtaining financial resources or returns on investments.</li> <li>• An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources.</li> <li>• Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.</li> </ul>
Debt Covenant Violation	<ul style="list-style-type: none"> <li>• Debt covenant violations may be cured after the balance sheet date eliminating the need to reclassify the debt.</li> </ul>	<ul style="list-style-type: none"> <li>• Curing a debt covenant violation after the balance sheet date may not eliminate the need to reclassify the debt.</li> </ul>
Investment Property	<ul style="list-style-type: none"> <li>• No specific definition of investment property. Investments in land and buildings are accounted for as property, plant, and equipment.</li> </ul>	<ul style="list-style-type: none"> <li>• Separate accounting guidance for investment property.</li> <li>• Investment property is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes, or sale in the ordinary course of business.</li> </ul>
Component Depreciation	<ul style="list-style-type: none"> <li>• No requirement for separate components of an asset (nor is there a prohibition against doing so).</li> <li>• Composite depreciation method may be used.</li> </ul>	<ul style="list-style-type: none"> <li>• If the major components of an item of property, plant, and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each</li> </ul>

Topic	FRF for SMEs Accounting Framework	IFRS for SMEs
Component Depreciation (Continued)		such component separately over its useful life.
Joint Ventures	<ul style="list-style-type: none"> <li>• A venturer should make an accounting policy choice to account for its interests in joint ventures using one of the following methods: <ul style="list-style-type: none"> <li>— Equity</li> <li>— Proportionate consolidation <ul style="list-style-type: none"> <li>• Only applicable to unincorporated entities in which it is an established industry practice</li> </ul> </li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Investments in jointly controlled entities may be accounted for using one of the following methods: <ul style="list-style-type: none"> <li>— Cost (if there is no published price quotation)</li> <li>— Equity</li> <li>— Fair-value-through-earnings</li> </ul> </li> </ul>
Impairment of Long-Lived Assets	<ul style="list-style-type: none"> <li>• No assessment of impairments for long-lived assets.</li> <li>• A depreciated or amortized cost approach is followed. Assets no longer used are written off.</li> </ul>	<ul style="list-style-type: none"> <li>• Impairment testing is required only when there is an indicator of impairment.</li> </ul>
Contingencies	<ul style="list-style-type: none"> <li>• A contingency is recognized when it is probable that a future event will confirm that the value of an asset has diminished or a liability incurred at the date of the financial statements and the amount of the loss can be reasonably estimable.</li> <li>• <i>Probable</i> is defined as likely to occur, a threshold higher than the "more likely than not" threshold used in IFRS for SMEs.</li> </ul>	<ul style="list-style-type: none"> <li>• A contingency is recognized when it is more likely than not that the entity will be required to transfer economic benefits in settlement and the amount of the obligation can be estimated reliably.</li> </ul>
Income Taxes	<ul style="list-style-type: none"> <li>• Policy choice to account for income taxes using either the taxes payable method or the deferred income taxes method.</li> </ul>	<ul style="list-style-type: none"> <li>• Income taxes accounted for using a deferred income tax method.</li> <li>• Uncertain income tax positions must be evaluated and accrual made if certain conditions are met.</li> </ul>



Topic	FRF for SMEs Accounting Framework	IFRS for SMEs
Income Taxes (Continued)	<ul style="list-style-type: none"> <li>No evaluation or accrual of uncertain tax positions.</li> </ul>	
Borrowing Costs	<ul style="list-style-type: none"> <li>An entity can choose to capitalize interest costs related to an item of property, plant, and equipment that is acquired, constructed, or developed over time.</li> <li>When a financial liability is issued or assumed in an arm's length transaction, an entity should measure it at its exchange amount adjusted by financing fees and transaction costs that are directly attributable to its origination, acquisition, issuance, or assumption.</li> <li>An entity can choose to capitalize interest costs related to inventories that require a substantial period of time to get them ready for their intended use or sale.</li> </ul>	<ul style="list-style-type: none"> <li>Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. An entity should recognize all borrowing costs as an expense in net income in the period in which they are incurred.</li> </ul>
Long-Lived Assets Held for Sale	<ul style="list-style-type: none"> <li>A long-lived asset to be sold should be classified as held for sale and presented separately in the entity's statement of financial position. The assets and liabilities of a disposal group classified as held for sale should be presented separately in the asset and liability sections, respectively, of the statement of financial position.</li> <li>A long-lived asset should not be amortized while it is classified as held for sale.</li> </ul>	<ul style="list-style-type: none"> <li>There is no "held for sale" classification for nonfinancial assets or groups of assets and liabilities and related measurement provisions.</li> </ul>

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