

22 September 2004

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**NEW ZEALAND TREASURY SUBMISSION ON THE IASB DISCUSSION
PAPER: *PRELIMINARY VIEWS ON ACCOUNTING STANDARDS FOR
SMALL AND MEDIUM-SIZED ENTITIES***

Please find attached the New Zealand Treasury's submissions in respect of the above mentioned discussion paper.

In summary, we support SMEs being exempt from some of the reporting requirements of IFRS where the costs of such requirements outweigh the benefits.

However, we disagree with SME reporting requirements being produced in a separate set of standards. We would prefer an approach that is similar to New Zealand's approach where differential reporting of SME exemptions are identified within each standard.

Our detailed comments to the specific matters requested by the IASB are attached for your consideration.

Warwick White (warwick.white@treasury.govt.nz) and Steve Leith (steve.leith@treasury.govt.nz) are happy to discuss these comments further if required.

Yours sincerely

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for Secretary of the Treasury

IASB DISCUSSION PAPER: PRELIMINARY VIEWS ON ACCOUNTING STANDARDS FOR SMALL AND MEDIUM-SIZED ENTITIES

IASB QUESTIONS:

Issue 1. Should the IASB develop special financial reporting standards for SMEs?

Question 1a – Do you agree that full IFRSs should be considered suitable for all entities? If not, why not?

IFRS are developed for, and therefore should be considered suitable for, profit-oriented entities. IFRS are not, however, suitable for *all entities*. For example, IFRS are not suitable for public benefit entities. Hence the need for New Zealand to insert public benefit entity sections into IFRS in order to make them sector neutral (these sector neutral standards are NZ IFRS). Nevertheless, we agree with the underlying policy intent that full IFRSs should be considered suitable for profit-oriented entities (i.e. they are the default standards for these entities) and are therefore the appropriate platform for the design of any differential reporting regime. Similarly, we consider that NZ IFRS are a suitable platform for designing sector neutral SME financial reporting requirements.

Question 1b – Do you agree that the Board should develop a separate set of standards for SMEs? If not, why not?

We support the option of differential reporting by SMEs and therefore support the IASB developing and promulgating such a framework.

We do not, however, support development of a “separate set of standards” as envisaged by the IASB. Rather, we support the approach used in New Zealand of a Differential Reporting Framework that identifies within each standard exemptions available to SMEs. The benefits of this approach include ensuring SME implications are considered in the development or amendment of IFRSs (thus maintaining the quality of SME reporting), ensuring a consistent framework is applied, clearly conveying what the ‘default option’ is should an SME exemption not be followed, and lowering costs to users/practitioners as they do not need to learn and interpret two sets of standards.

Question 1c – Do you agree that IASB standards for SMEs should not be used by publicly listed entities (or other entities not specifically intended by the Board), even if national law or regulation were to permit this? Do you also agree that if the IASB Standards for SMEs are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs? If not, why not?

We strongly support a clear and unambiguous statement in financial reports and audit opinions regarding the basis on which the financial statements were prepared, whether that is with IFRS or with a permitted differential reporting framework.

In principle we agree publicly listed entities should comply with full IFRS. However, it is for national jurisdictions (or capital markets and other users) to set the requirements as to which entities should be required to report under full IFRS and which should be permitted to follow SME reporting requirements. We are not convinced that this is the role of the IASB, not least because the IASB cannot exclude entities from applying its standards.

Issue 2. What should be the objectives of a set of financial reporting standards for SME?

Question 2. Are the objectives of IASB Standards for SMEs as set out in preliminary view 2 appropriate and if not, how should they be modified?

We consider the objectives are appropriate for determining the reporting requirements of SMEs. As discussed in question 1b, we do not support development of a separate set of standards.

Issue 3. For which entities would IASB Standards for SMEs be intended?

Question 3a. Do you agree that the Board should describe the characteristics of the entities for which it intends the standards but that those characteristics should not prescribe quantitative 'size tests'? If not, why not?

We support the IASB providing guidance on characteristics such as size and public accountability. Doing so communicates the intended audience thereby assisting national jurisdictions in determining eligibility criteria for differential reporting.

But as discussed in question 1c, the IASB should not prescribe tests to determine who can use its differential reporting framework.

Question 3b. Do you agree that the Board should develop standards that would be suitable for all entities that do not have public accountability and should not focus only on some entities that do not have public accountability, such as only the relatively larger ones or only the relatively smaller ones? If not, why not?

We agree that the Board should develop differential reporting requirements suitable for all entities likely to apply these requirements. We discuss our views on the definition of public accountability in question 3c.

Question 3c. Do the two principles in preliminary view 3.2 combined with the presumptive indicators of public accountability in preliminary view 3.3, provide a workable definition and appropriate guidance for applying the concept of 'public accountability'? If not, how would you change them?

We consider the principles and indicators of public accountability to be appropriate guidance to national jurisdictions when considering which profit-oriented entities should be permitted to use the SME reporting requirements.

This guidance is not suitable for all entities, however. For example, applying the IASB guidance to New Zealand's sector neutral standards would inappropriately result in many small "publicly accountable" entities (e.g. schools, some which have less than 20 students in rural areas) having to fully comply with New Zealand equivalents to IFRS.

Hence the need for national jurisdictions, not the IASB, to set eligibility requirements for SME reporting.

Question 3d. Do you agree that an entity should be required to use full IFRSs if one or more of the owners of its shares object to the entity's preparing its financial statements on the basis of IASB Standards for SMEs? If not, why not?

We agree that owners should be able to require an entity to fully apply IFRSs. But again, it is for national jurisdictions to set such parameters, not the IASB. We would also caution against permitting a single shareholder to require compliance with full IFRS as this could open the door to abuse by a disaffected minority shareholder who owns only a tiny proportion of the entity.

We suggest the IASB offer guidance that a minority of shareholders should be able to demand full IFRS financial statements, but leave it to individual jurisdictions to determine at what level that minority should be.

Question 3e. Do you agree that if a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements of its parent, venturer or investor, the entity should comply with full IFRSs, and not IASB Standards for SMEs, in its separate financial statements? If not, why not?

The reasons for this requirement are not clear from the Discussion Document (refer paragraph 39). Reference is made to the cost of producing a second set of financial statements, but if this cost is material then a subsidiary, joint venture or associate will choose to issue full IFRS compliant financial statements and avoid the additional cost of dual reporting.

In the absence of a compelling argument as to why SMEs should be required to report on a full IFRS basis, we consider that the reporting requirements should not be determined by who owns an entity.

Issue 4. If IASB Standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, how should that entity resolve the issue?

Question 4. Do you agree that if IASB Standards for SMEs do not address a particular accounting recognition or measurement issue that is addressed in an IFRS, the entity would be required to look to that IFRS to resolve that particular issue? If not, why not, and what alternative would you propose?

We agree with this proposal. This is the natural consequence of our preferred approach discussed in 1b, which is to have one set of standards applying to all entities with SME reporting exemptions identified within each standard. It is clear under this approach that the full IFRS is the default standard.

Issue 5. May an entity using IASB Standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB Standard for SMEs?

Question 5a. Should an SME be permitted to revert to an IFRS if the treatment in the SME version of the IFRS differs from the treatment in the IFRS, or should an SME be required to choose only either the complete set of IFRSs or the complete set of SME standards with no optional reversion to individual IFRSs? Why?

As per question 4, if SME exemptions are an integral part of the IFRS then this issue is mitigated (if not eliminated). Even so, as the presumption should be that the full IFRS is superior to the SME reporting requirement, SME's should be encouraged to apply the full IFRS standard wherever practicable.

Question 5b. If an SME is permitted to revert to an IFRS, should it be:

(a) required to revert to the IFRS in its entirety (a standard-by-standard approach);

(b) permitted to revert to individual principles in the IFRS without restriction while continuing to follow the remainder of the SME version of the IFRS (a principle-by-principle approach); or

(c) required to revert to all of the principles in the IFRS that are related to the treatment in the SME version of that IFRS while continuing to follow the remainder of the SME version of the IFRS (a middle ground between a standard-by-standard and principle-by-principle approach)?

Please explain your reasoning and, if you favour (c), what criteria do you propose for defining "related" principles?

Under our preferred approach in question 1b above, entities would be free to comply with some of the full disclosure requirements that they have been exempted from. Indeed, in New Zealand there are circumstances where auditors have insisted on the additional disclosures where this is necessary to give the "true and fair" view.

With respect to measurement, we think that if an entity reverted to the full IFRS measurement basis, it should also be required to comply with the related disclosures. To take a hypothetical example, say the SME Standard on agriculture permitted biological assets to be measured on the historical cost basis, rather than fair value. If an entity that qualified for SME Standards decided to use fair value as its measurement basis, it should also be required to make the disclosures set out in IAS 41.

However, if separate SME standards were developed then we envisage problems with attempting to implement any of the above options. Options (b) and (c) assume that IFRS are principles based and that these principles are readily evident. We are not convinced that this is always the case. As for option (a), it assumes that each SME standard will align with an IFRS and that they are interchangeable, which is unlikely to be the case. For example, how could an SME revert to IAS 1 or IAS 8 and also apply remaining SME standards? The interdependencies between standards make this a difficult task.

Issue 6. How should the Board approach the development of IASB Standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?

Question 6. Do you agree that development of IASB Standards for SMEs should start by extracting the fundamental concepts from the Framework and the principles and related mandatory guidance from IFRSs (including Interpretations),

and then making modifications deemed appropriate? If not, what approach would you follow?

As outlined in question 1c, we support SME exemptions being identified within the full IFRS Standard. In this way, the concepts, principles (where evident) and mandatory guidance will automatically be identical, unless specifically amended.

Issue 7. If IASB Standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?

Question 7a. Do you agree that any modifications for SMEs to the concepts or principles in full IFRSs must be on the basis of the identified needs of users of SME financial statements or cost-benefit analyses? If not, what alternative bases for modifications would you propose, and why? And if so, do you have suggestions about how the Board might analyse the costs and benefits of IFRSs in an SME context?

The demand for having SME exemptions arises from the desire to reduce compliance costs of SMEs relative to the benefits accruing to users. Accordingly, cost-benefit is an appropriate, albeit difficult, criterion to use for identifying SME reporting requirements.

We are not convinced that users' needs are also a suitable basis for developing SME reporting requirements as it is not clear how their needs differ to users of full IFRS financial statements.

Question 7b. Do you agree that it is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost-benefit analyses and that the disclosure modifications could increase or decrease the current level of disclosure for SMEs? If not, why not?

Our response to question 7a applies to this question also. We also do not consider that requirements for SMEs should exceed those required under full IFRS of other entities. Furthermore, if SMEs can revert to the full IFRS then they are unlikely to comply with a more onerous SME reporting requirement.

Question 7c. Do you agree that, in developing standards for SMEs, the Board should presume that no modification would be made to the recognition or measurement principles in IFRSs, though that presumption could be overcome on the basis of user needs and a cost-benefit analysis? If not, why not?

We agree there should be a presumption that the recognition and measurement principles would remain unchanged. But, there may be situations where cost-benefit criterion would support changes to recognition and measurement. For example, use of historical cost rather than fair value, or tax rates for depreciation. Accordingly, while the *presumption* of no modification is appropriate, it should not be an absolute criterion.

Issue 8. In what format should IASB Standards for SMEs be published?

Question 8a. Do you agree that IASB Standards for SMEs should be published in a separate printed volume? If you favour including them in separate sections of

each IFRS (including Interpretations) or some other approach, please explain why.

As explained in question 1c, we strongly disagree with the creation of a separate set of SME Standards. Having them in a separate volume would create a disconnect that will be difficult to overcome. It will also add to the cost of practitioners and users, particularly those whose activities span both SMEs and larger entities, as they will have to learn yet another set of standards. It will also add to the considerable workload of the IASB and national standard setters, with the likely result being an erosion in the quality of SME standards and reporting.

Question 8b. Do you agree that IASB Standards for SMEs should be organised by IAS/IFRS number rather than in topical sequence? If you favour topical sequence or some other approach, please explain why.

See our response to question 8a above.

Question 8c. Do you agree that each IASB Standard for SMEs should include a statement of its objective, a summary and a glossary of key terms?

There would be no reason for these if the SME Standards were an integral part of the full IFRS. The need for such requirements further demonstrates the likely disconnect that will occur between IFRS and SME standards, and an erosion of a conceptual framework underpinning SME standards.

Question 9. Are there any other matters related to how the Board should approach its project to develop standards for SMEs that you would like to bring to the Board's attention?

No.