

***Preliminary Views on Accounting Standards
for Small and Medium-sized Entities (IASB, 2004)***

CL 5

Comments by
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Question 1a. Do you agree that full IFRSs should be considered suitable for all entities?

- No.
- Full IFRSs are designed for the users of the financial statements of large listed companies and the capital markets. Therefore, many IFRSs are irrelevant to SMEs and the users of their accounts. The users of the financial statements of SMEs are very different.²

Question 1b. Do you agree that the Board should develop a separate set of financial reporting standards suitable for SMEs?

- Yes.

Question 1c. Do you agree that IASB Standards for SMEs should not be used by publicly listed entities (or any 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?

- Yes to both questions.

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?

- In principle, yes, but preliminary view 2(a) should include the word 'comparable'.
- Presumably 'objectives' refers to the objectives of the preparers, since inanimate objects cannot have objectives.
- Presumably 'understandable' refers to both preparers and users. In the case of preparers I agree with the objective. Research shows that in the majority of SMEs the preparer is an external accountant.³ However, as far as users are concerned, it is unlikely that they will have an understanding of accounting concepts. Their needs are for high quality and understandable financial statements. This does not necessarily mean that they have to understand the accounting concepts underpinning the preparation of annual accounts.
- It is unlikely that IASB Standards for SMEs will be 'enforceable' in all jurisdictions. The cost of enforcement would exceed any benefit. Entities would be motivated to comply with the standard because they increase the usefulness of the accounts to external users such as lenders and creditors. In the case of the UK FRSE, rapid, widespread adoption was facilitated by the development of suitable accounting software. It is likely that the same would

¹ The views expressed in this document are the personal views of the author.

² See for example, Jarvis, R. (1996) *Users and Uses of Unlisted Companies' Financial Statements: A literature Review*, London: ICAEW; Collis, J. and Jarvis, R. (2000) *How owner-managers use accounts*, London: ICAEW.

³ Collis, J. and Jarvis, R. (2002) 'Financial Information and the management of small private companies', *Journal of Small Business and Entrepreneurship Development*, 9(2), pp. 100-110.

happen with IASB Standards for SMEs. Thus, the software would proxy for enforcement, since to deviate from the software could increase costs.

- It is important that the IASB focuses on making financial statements useful to users, which means they are based on the same conceptual framework as IFRSs and will allow easy transition to full IFRS if necessary.

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, and how would an appropriate size test be developed?

- Yes.

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?

- In principle, yes.
- The reference to 'larger' and 'smaller' is confusing, since preliminary view 3.1 suggests no quantitative size tests. This concept requires careful definition to avoid multiple interpretations. For example, what is a 'high degree of interest' (see preliminary view 3.2)?

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?

- It would be better to concentrate on user needs. If an SME were classified as publicly accountable it would be subject to the same standards as listed entities and the needs of its users would be seen as compatible with the needs of users in the capital markets.
- It would be preferable to differentiate on the basis of listed versus unlisted entities as this would capture the difference in user needs.
- Collectively, SMEs make a significant contribution to national economies⁴ and describing them as not being publicly accountable implies that their contribution and role is less than that of listed entities.

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 preparing its financial statements on the basis of IASB Standards for SMEs? If not, why not?

- No. This is not the same situation as exemption from the statutory audit, where it is important to protect the needs of minority shareholders who want the additional assurance that the audit carries.⁵ The objectives of IASB Standards for SMEs and full IFRSs should be the same: to provide high quality information that is useful to users. It is likely that many of the IFRSs do not apply to SMEs.
- It is unlikely that shareholders of SMEs would understand the distinction between the two sets of standards.

⁴ See for example, Observatory of European SMEs (2002) *SMEs in Focus*, Luxembourg: Office for Official Publications of the European Communities.

⁵ Collis, J., Jarvis, R. and Skerratt, L. (2004) "The Demand for the Audit in Small Companies in the UK", *Accounting & Business Research*, 34 (2), pp. 87-100.

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?

- Yes.

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

- Yes.

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?

- Yes.

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?

- SMEs should be permitted to revert to individual principles in the full IFRS while continuing to follow the remainder of the SME version (a principle-by-principle approach). By giving SMEs this option, preparers can ensure they adopt standards that are relevant to the SME.
- The need for comparability is an important issue here.

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?

- Yes.

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?

- Yes.
- Any modifications for SMEs must be based primarily on user needs.

- Costs are relatively easy to identify. Once accounting software is widely available, there should be little difference in the cost of preparing accounts based on national or international standards.
- Benefits are intangible and therefore cannot be quantified. Perceptions of preparers (practicing accountants) will be an important influence on the perceptions of management and other users of the accounts of SMEs.

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?

- Meeting user needs and ensuring that the benefits exceed the costs of SME financial reports should result from disclosure, presentation modification and amendments to measurement and recognition aspects from the full IFRS.
- If amendments are not made to measurement and recognition aspects from full IFRSs, it is likely that the overall size of and complexity of IASB Standards for SMEs will only be reduced marginally.

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?

- No, on the basis of user needs and the cost/benefit question.

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.

- Yes.

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.

- No. IASB Standards for SMEs should be in topical sequence and references should be provided to relevant full IFRSs. It may be feasible to follow the UK model where the FRSE contains all the standards likely to apply to SMEs in a single publication.
- If a sequential numerical system were adopted, it would not match the numerical system for full IFRSs as some are not relevant to SMEs.

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?

- Yes.