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**Discussion Paper: *Preliminary Views on Accounting Standards for Small and Medium-sized Entities***

Dear Paul

Grant Thornton is pleased to comment on the International Accounting Standards Board (the Board) Discussion Paper: *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* (the Paper). Indeed, we applaud the Board for issuing a paper of preliminary views for wide consultation. This is an outstandingly important project, and we welcome the clear message that the Board is earnest in seeking early counsel as to its fundamental premises. This must be followed by appropriate action by the Board in response to what it hears, so that the eventual product is focused primarily on the needs of the sector that the Board seeks to serve.

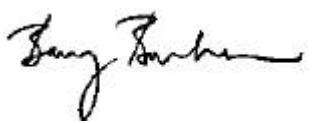
We believe that the Board should progress this project, preferably augmenting its resources by a project team dedicated to accounting by small and medium-sized entities (SMEs). We express our detailed views on the questions raised in the paper in the attached appendix. Key principles underlying our response are:

- i The primary focus in developing accounting standards for SMEs must be to respond to the needs of users of those financial statements. Research to establish those needs is important.
- ii The outline description of no public accountability, rather than any size test, represents broadly the right boundary characteristic, although ultimately prescription of use of IFRS or these proposed SME standards falls to regulators in various jurisdictions.

- iii In pursuing the overall aims of the project, the Board must be open to, and expectant of, significant differences in recognition and measurement from IFRS: in particular fair values may be relevant in far fewer cases.

If you have any questions on our response, or wish us to amplify our comments, please contact our Director of International Financial Reporting. April Mackenzie ([april.mackenzie@gt.com](mailto:april.mackenzie@gt.com) or telephone +1 212 624 5428).

Yours sincerely



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## **Appendix:**

### **Discussion Paper: *Preliminary Views on Accounting Standards for Small and Medium-sized Entities*. Answers to specific questions**

For brevity, we have adopted the shorthand "IFRS SME" for the proposed standards under discussion. However, as noted under question 9 below, we consider the term "SME" as such to be misleading in this context, and that different terminology should be found.

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

We do not regard full IFRS as *suitable* for all entities. Although we agree that it can be applied to all entities, it is unnecessarily complex for many owner-managed businesses, as it has been built up by considering the needs of the international capital markets. Its very lack of suitability is a prime reason that we support the development of IFRS SME.

#### **Question 1b - *Do you agree that the Board should develop a separate set of financial reporting standards suitable for SMEs? If not, why not?***

We agree that the Board should develop a separate set of financial reporting standards suitable for SMEs (subject to our comments below regarding the term SME, and the nature of the set of standards). In our view the IASB (rather than another agency) should take the leadership in carrying out this project. If the Board were not to venture on this project, other organisations, and maybe more than one, are most likely to try to provide SME standards, and a proliferation of standards for SME like entities would emerge. We do not consider this a good result for the growth of the world economy, even when those SMEs may be domestic operating entities.

#### **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?***

In our view the optimum role for the Board is to produce a set of IFRS SME that it believes will be a suitable basis for general purpose financial reporting by a range of entities, whose needs are not being well met by full IFRS. In doing so, the Board should specify the characteristics of the entities that it has in mind as users of IFRS SME, consideration of which have shaped their development. However, the Board, having done that and delivered a product, it then falls to governments and regulators to prescribe when IFRS SME shall, or may, be used, according to the needs of the particular environment.

On the basis that financial statements prepared in accordance with IFRS SME will state that fact, and that auditors will refer to it as well, it would seem to be transparent which standards have been used. Although we would not expect the regulatory authorities of publicly listed companies to permit the use of IFRS SME, we do not see it as the Board's

job to make that decision for them. We observe that the Board does not place a similar restriction on the use of full IFRS by very small companies for whom it is not appropriate.

**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 our view there are two main objectives in developing IFRS SME:

- to reduce the financial reporting burden on SMEs that want to use globally-recognised standards, and
- to do that by focussing on the needs of the users of SME financial statements.

The first of these relates to preparers, and the second to users. Both recognise that the intention of IFRS SME is to provide consistent financial information sufficient to meet users' needs in this environment, but that preparers' capabilities, and users' needs, are likely to be less than in an investor-orientated environment for which IFRS are developed. The above objectives are similar to those listed as (b) and (d) at paragraph 16 of the Paper. In respect of users' needs, we would expect that considerations of stewardship and profits available for distribution may increase in importance compared with the needs of the users of IFRS financial statements for publicly traded entities. Similarly, sensitivity analyses, fair values and other predictive indicators may be of less importance. We urge the IASB to conduct research into users' needs to assist their project.

However we acknowledge that this can be a “chicken and egg” situation. Users' needs must be established, the target market for using IFRS SME must be determined, and the form and content of the standards must be decided. Each needs an input from the others.

We commend the Board for having issued this Preliminary Views Discussion Paper, and urge them to continue developing on all fronts at once, not being afraid to expose partly-completed work for comment. In particular, whilst we commend research into users' needs, we would not want that to hold up work on what might be appropriate content on particular standards. We acknowledge that there are a great variety of potential users of IFRS SME, of different sizes and circumstances, in many different legal environments, with many different levels of accounting resource available locally. Whatever the Board develops will not satisfy all needs everywhere. But research and consultation should establish the characteristics of the target market that the Board can reasonably hope to reach.

In respect of paragraph 16 objectives (a) (c) and (e), we observe:

(a) is an excellent objective, provided that the value of high quality is not permitted to dominate the concepts of burden reduction and meeting users' needs in (b) and (d).

(c) is a good starting point, and we would expect that some basic aspects of the framework, such as elements, would remain unchanged. However, the Board should be open to the possibility that the framework for SMEs may differ from the main Framework, particularly due to the change in users' needs.

(e) falls into the category of "would be nice", but again pursuit of this should not hinder achievement of objectives (b) and (d). The vast majority of entities never transition to becoming publicly accountable and requiring full IFRS.

**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?**

We agree. In our view the qualitative characteristics are more important in determining appropriate accounting. National regulators can prescribe additional size criteria if they wish, appropriate to their environment and intention.

**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 doubt that it is possible to develop standards that would apply effectively to all entities without public accountability - some may have large and complex operations and full IFRS be more suitable, whereas others will be too small to benefit from an internationally recognised accounting basis. Therefore we recommend that the Board focus on the characteristics and users' needs, and provide some explanation as to the entities for which the standards may or may not be suitable. As explained above, in the end it is for regulators to prescribe which entities shall, or may, use IFRS SME.

We note that jurisdictions may not require financial statements from their smallest entities, but only selected financial information. These entities would constitute a "third tier", to which IFRS SME would not be applied.

**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 agree that the concept of "public accountability" should be developed to be the basis for determining the form and content of IFRS SME. However, we would build the concept only on the ideas in paragraph 28(a).

Consistent with our argument that the Board should endeavour to produce IFRS SME with an anticipated spectrum of the entities for which it was relevant, but that it is the regulators who prescribe who shall apply it, we have no need for the prescriptive content of paragraphs 28(b) and (c) and 31. It may be that it helps the Board to have such examples in mind when developing IFRS SME and commentary of this kind would be helpful, as pointed out in 3b above.

In any case, we are not entirely convinced by the arguments in paragraph 31 (b) and (c). It seems unlikely to us that the depositors, or public service users, will pursue their claims against the entity primarily using the medium of its financial statements. Nevertheless, we acknowledge that regulators may generally choose to require full public accountability.

**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?**

Again we consider that this is properly a matter either for governments or for the internal arrangements for the entity involved.

**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?*

No. This is a matter for governments or the group of companies involved.

**Question 4** - *Do you agree that if IASB Standards of 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?*

We consider that preliminary view 4 of mandatory fallback is flawed because it is not consistent with the key objective of reducing the financial reporting burden on SMEs, as argued in paragraph 45. Also, with the increasing complexity of IFRS, such fall-back, even on a standard by standard basis, could submerge an SME in major reporting issues, as example 4A illustrates. This could defeat the other objective, which relates to users' needs.

Therefore we favour the approach described as "IFRSs as guidance for exercising judgment", which is in fact more in line with the words of Question 4 "...the entity should be required to look to the appropriate IFRS to resolve that particular issue". Using the full IFRS to establish current practice for transactions that are unusual or complex for an SME (which is presumably why they were not dealt with in IFRS SME in the first place) commends itself as an appropriate, pragmatic, way of working. We are aware that this approach has worked very effectively in the UK for a number of years. Care will be needed in expressing the requirement, and in considering whether the framework for SMEs matches the full IFRS framework for that issue.

**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?**

We cannot see the justification for permitting optional reversion to IFRS where the treatment is different from that in IFRS SME. In our view, that would introduce opportunity for arbitrage, and for unnecessary lack of consistency. In addition, if an entity determines generally that its users' financial reporting needs are met by the framework underlying IFRS SME, they should remain with that: importing parts relevant to investor-oriented reporting is not appropriate. Of course, unless it was misleading or confusing, additional voluntary disclosure would always be permissible.

**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?*

We favour (b) if entities were to be permitted to revert to an IFRS.

**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?**

We agree that IFRS should be the starting point for developing IFRS SME, because they represent a coherent set of standards for financial reporting. However, we emphasise that the review of users' needs and the determination of the likely target market for IFRS SME may necessitate significant changes to the underlying concepts, as explained above, and have a significant effect on the modifications to existing IFRS to make them suitable 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 any suggestions**

*about how the Board might analyse the costs and benefits of IFRSs in an SME context?*

We agree with the proposal. However, the determination of the entities that might use IFRS SME and the needs of their users must precede the cost-benefit analysis.

**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?***

Yes

**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. It would be foolish to make such a presumption, and we strongly urge the Board not to have such a mindset in their initial discussions on individual IFRS. We could agree to a proposition that user needs and preparer cost/benefit analyses would drive changes to recognition and measurement principles, but not the proposition as formulated in the question.

In fact, we suspect that it is quite likely that the focus on fair values and heavily prescribed measurement methods in IFRS that are relevant to the investor community, will turn out, when the user needs research is done, to be much less important for SMEs.

**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. We strongly urge the Board to aim at a single printed volume. To put the IFRS SME in with the IFRS would be counter to the objective of reducing burdens on preparers.

**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?***

If they are intended to be readable and easy to follow, they should be in topical sequence, rather than the sequence in which the IASB and IASB historically addressed subjects.

**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, if these add to usability. The glossary of key terms could probably be presented for the whole book, rather than standard by standard.

**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?***

Because there are many important calls on the Board's time and also because the user constituency for IFRS SMEs is different from that for the IFRS that the Board is usually considering, we believe that the Board would do well to set up a sub-group of people familiar with SME issues to progress this project. The Board would have the final approval.

It is important to find a title that expresses the types of entities for which these standards are intended better than "SMEs", which means different things in different jurisdictions, and almost certainly involves size criteria. The phrase "public accountability", whilst useful for discussion, could also be misleading: most entities have public accountability to society, which they discharge by actions such as filing their financial statements at a central registry.

In due course, the Board will also need to address first-time adoption issues.