

Preliminary Views on Accounting Standards for Small and Medium-sized Entities
IASB Discussion Paper
Comments

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ISSUE 1: DEVELOPMENT OF SPECIAL FINANCIAL REPORTING STANDARDS FOR SMEs BY IASB.

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

Response: No. Reasons explained in attached report.

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

Response: Yes. See response to Question 1a.

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?

Response: Yes. I agree that IFRSs 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.
Additionally, if the IFRSs for SMEs are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs.

ISSUE 2: OBJECTIVES OF FINANCIAL REPORTING STANDARDS FOR SMEs

Preliminary View 2: Objectives of IASB Standards for SMEs. Financial reporting standards for SMEs should:

- (a) provide high quality, understandable and enforceable accounting standards suitable for SMEs globally;
- (b) focus on meeting the needs of users of SME financial statements;
- (c) be built on the same conceptual framework as IFRSs;

- (d) reduce the financial reporting burden in SMEs that want to use global standards;
- (e) allow easy transition to full IFRSs for those SMEs that become publicly accountable or choose to switch to full IFRSs.

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?

Response: The objectives of IASB Standards for SMEs as set out in preliminary view 2 are not appropriate. Suggested modification as follows:

Objectives of IASB Standards for SMEs. Financial reporting standards for SMEs should:

- (a) provide high quality, understandable and enforceable accounting standards suitable for SMEs globally;
- (b) focus on meeting the needs of users of SME financial statements;
- (c) delete
- (d) delete
- (e) delete

Rationale for modification:

If the objectives of financial reporting standards for SMEs encompass (a) and (b), then it follows logically that (c) cannot be true since it is acknowledged that the users of SMEs (ie. no dependent users) are different from users of financial statements of entities (dependent users exist) which apply full IFRSs.

Moreover, (c) is not an objective rather it denotes how the financial reporting standards for SMEs shall be set out.

Further (d) and (e) are not objectives, rather they are the anticipated consequences if financial reporting standards for SMEs are in place.

ISSUE 3: APPLICATION OF IASB STANDARDS FOR SMEs

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?

Response: Yes, I 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" as these should be left to the national jurisdictions to determine based on their business environment.

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?

Response: Yes. I agree that the Board should develop standards that would be suitable for all entities that do not have public accountability.

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?

Response: Yes. I am of the opinion that 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".

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?

Response: No. I do not 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. I believe, so long as the entity meets the definition of SME demonstrates it does not have public accountability as set out by the preliminary views 3.2 and 3.3., the entity should comply with IFRS for SMEs. Otherwise, there will not be comparability amongst SMEs globally.

Question 3e: Do you agree that if a subsidiary, joint venture or associates 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?

Response: Yes. I agree if a subsidiary, joint venture or associates 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. In such cases this entity is presumed to

have public accountability and therefore cannot apply not IASB Standards for SMEs.

ISSUE 4: SITUATIONS WHERE NOT IASB STANDARDS FOR SMEs DO NOT ADDRESS A PARTICULAR ACCOUNTING RECOGNITION OR MEASUREMENT ISSUE

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?

Response: No. I do not agree that if the 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. Since the IFRSs are premised on needs of users of financial statements of entities with public accountability (for which there are dependent users) and the perspective that drives the conceptual framework that guides the formulation of IFRSs is that of *informational value* and *decision-usefulness*, it stands to reason that perhaps the IASB Standards for SMEs should be based on a modified version of the current conceptual framework from which IFRSs are derived. The modification should be attentive to the needs of the users of SMEs and the appropriate perspective such as "*stewardship*" and "*accountability*". This is elaborated in attached paper.

ISSUE 5: Whether an entity using IASB Standards for SMEs should be allowed to 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?

Response: An SME should 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. This is due to my understanding that the SME standards are premised on the needs of the users of SMEs and that the conceptual inclination will differ from the IFRSs as elaborated in attached paper. Hence, it is only logical that no optional reversion to IFRS be allowed. Otherwise, it will lead to "cherry picking".

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)?

Response: In the event that an SME is allowed to revert to an IFRS (which I believe should be rare) it should be 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). This follows logically from the discussion provided in the attached paper.

ISSUE 6: APPROACH TO DEVELOPMENT OF SME STANDARDS. EXTENT TO WHICH THE FOUNDATION OF SME STANDARDS ARE BASED ON 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 Interpretation), and then making modifications deemed appropriate? If not, what approach should you follow?

Response: Yes. I believe the conceptual framework upon which IFRSs are based should be the logical starting point. Appropriate modifications should then be made in the light of the needs of users of SMEs and the purpose of financial reporting as outlined in the attached CAPA report.

ISSUE 7: BASIS FOR MODIFYING 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?

Response: Yes. As elaborated in the attached paper, the concepts or principles in full IFRSs must be modified on the basis of the identified needs of users of SME financial statements, cost-benefit analyses and the agreed upon purpose of financial reporting for SMEs. There needs to be empirical support for the formulation of the needs of users of SMEs. A suggestion would be to evaluate on a regional basis the prominent group of users of financial reports of SMEs

in the region. Regional as well as national feedback will be useful for IASB in focusing on the needs of such users.

Question 7b: Do you agree that it is likely that disclosures 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 disclosures for SMEs? If not, why not?

Response: Yes. It is envisaged that it is likely that disclosures 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 disclosures for SMEs.

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 in cost-benefit analyses? If not, why not?

Response: No. I do not believe the board should presume that no modification would be made to the recognition or measurement principles in IFRSs. As suggested in the accompanying paper, the fundamental difference between the IFRSs and SME standards would be the identity of the user group. It follows logically that the purpose of financial reporting will differ for SMEs and hence it is not logical to start with the presumption that no modification would be made to the recognition or measurement principles in IFRSs. The key is to decide on the perspective that will inform the conceptualisation of financial reporting for SMEs, whether it will be "stewardship-accountability" perspective or "decision-usefulness" perspective or "informational-value" perspective that underlies current conceptual framework for IFRSs.

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 section of each IFRS (including interpretations) or some other approach, please explain why.

Response: Yes. I believe that the IASB Standards for SMEs should be published in a separate printed volume. It is useful if it can be web-published to ensure easy access for all SMEs.

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.

Response: Yes. I believe the IASB Standards for SMEs should be organised in topical sequence such as integrated in a balance sheet-income statement line item sequence like the *UK Financial Reporting Standards for Smaller Entities (FRSSE)*. The reason being this will provide a comprehensive guide to the accounting personnel of SMEs (who in most instances are not qualified professional accountants, especially in the developing countries). I suggest the SME standards also indicate if there is a IFRS on that issue so that the SMEs can refer if need arises. Otherwise, SMEs may need to go through an ever increasing volume of IFRSs to determine which ones are applicable for SMEs. Further, I anticipate there will be SME standards for which there are no equivalent IFRSs, for example, some procedural guidelines and Chart of Accounts and the like.

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

Response: Yes. I believe this should be so that it enlightens SME stakeholders.

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?

Response: My concern is that generally the perception is that participation of SME stakeholders in the international standard setting process is minimal or almost absent. In order to obtain proper feedback from these groups, the IASB has to reach out to these. Even at national jurisdictions, the involvement of SME stakeholder groups is minimal. Therefore, IASB has to ensure proper channels of communication and resort to harnessing the available resources at regional levels to obtain grounded understanding of the SME users and their needs before a framework for SME Standards is devised.

IASB Discussion Paper on Accounting Standards for Small and Medium-sized Entities

COMMENTS

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INTRODUCTION

The need to develop special financial reporting standards for Small and Medium-sized Entities (SMEs) by IASB is recognised in the research study issued in June 2003 entitled: *A Framework for Differential Reporting: A Response to ISAR's Accounting and Financial Reporting Guidelines for Small and Medium-sized Enterprises* (Confederation of Asian and Pacific Accountants, CAPA, 2003). As a researcher involved in the project, I am submitting my views for consideration by IASB. This paper draws on members' response to CAPA (2003) and provides the rationale for my response to IASB's Discussion Paper entitled *Preliminary views on accounting standards for Small and Medium-sized Entities*, released for comments in June 2004.

The discussion is organised in order of the issues raised in IASB's Discussion Paper.

DEVELOPMENT OF SPECIAL FINANCIAL REPORTING STANDARDS FOR SMEs BY IASB.

CAPA (2003) notes that development of IASB standards for SMEs is long overdue. The need for standards for SMEs is articulated in CAPA (2003). The fundamental issue is that the development of full IFRSs is based on a conceptual framework that is biased towards the investor and creditor user groups' needs. The critical concern is that user groups of SMEs (defined as those without public accountability) differ from those of entities with public accountability.

Conceptual issue

It is important to note that the conceptual framework upon which IFRSs are based evolved over time and the evolution transcends over a century during which businesses evolved and the forms of organisations transformed. In the mid-twentieth century, capital market participants and their needs became central to financial reporting that has a powerful connection with a fundamental premise of capital markets. This has also

fundamentally shifted focus of financial accounting and reporting from a revenue-expense matching perspective to a more disciplined concepts of "assets" and "liabilities". These concepts have been the building blocks for implementing a decision-usefulness objective that extends beyond the traditional stewardship objective of financial reporting. Some claim that in so doing, the "asset and liability" view has helped facilitate the evolution from the first - management- private investor dominated orientations towards the second - capital markets dominated orientation.

Therefore, it is clear that the full IFRSs that are premised on capital market participants' needs may not be suitable for all entities. It is important that IASB issue a separate set of financial reporting standards suitable for SMEs. Further, due to the different conceptual underpinnings, 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. Additionally, if the IFRSs for SMEs are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs.

OBJECTIVES OF FINANCIAL REPORTING STANDARDS FOR SMEs

Financial reporting standards for SMEs should provide high quality, understandable and enforceable accounting standards suitable for SMEs globally and focus on meeting the needs of users of SME financial statements. As explained earlier, it is observed that the users of SME financial statements differ. This also brings into consideration the purpose of financial reporting. The issue of whether it is stewardship- accountability perspective or decision-usefulness perspective, needs to be resolved. The resolution depends on who the users are and what their needs are.

APPLICATION OF IASB STANDARDS FOR SMEs

It is important to define SMEs and therefore, it is vital for the IASB to describe the characteristics of the entities for which it intends the standards. However, those characteristics should not prescribe quantitative "size tests" as these should be left to the national jurisdictions to determine based on their business environment. Clearly, using

"public accountability" concept to define SMEs eliminates the decision-usefulness perspective in financial reporting for SMEs.

SITUATIONS WHERE IASB STANDARDS FOR SMEs DO NOT ADDRESS A PARTICULAR ACCOUNTING RECOGNITION OR MEASUREMENT ISSUE

It follows, therefore, that if the IASB Standards for SMEs do not address a particular accounting recognition or measurement issue, the entity should not be required to look to the appropriate IFRS to resolve that particular issue. This is because the IFRSs are premised on needs of users of financial statements of entities with public accountability (for which there are dependent users) and the perspective that drives the conceptual framework that guides the formulation of IFRSs is that of *informational value* and *decision-usefulness*, it stands to reason that perhaps the IASB Standards for SMEs should be based on a modified version of the current conceptual framework from which IFRSs are derived. The modification should be attentive to the needs of the users of SMEs and the appropriate perspective such as "*stewardship*" and "*accountability*".

WHETHER AN ENTITY USING IASB STANDARDS FOR SMES SHOULD BE ALLOWED TO ELECT TO FOLLOW A TREATMENT PERMITTED IN AN IFRS THAT DIFFERS FROM THE TREATMENT IN THE RELATED IASB STANDARD FOR SMES.

As elaborated earlier, the user groups and purpose of financial reporting for SMEs are different from entities with public accountability. Therefore, an SME should 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. The SME standards are premised on the needs of the users of SMEs and that the conceptual inclination will differ from the IFRSs as elaborated above.

In the event that an SME is allowed to revert to an IFRS (in rather rare circumstances) it should be 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). This follows logically from the discussion above.

APPROACH TO DEVELOPMENT OF SME STANDARDS. EXTENT TO WHICH THE FOUNDATION OF SME STANDARDS ARE BASED ON CONCEPTS AND PRINCIPLES AND RELATED MANADATORY GUIDANCE IN IFRSs.

The current IASB framework evolved over a long period of time and is much influenced by developments in corporate USA. It is a useful and logical base from which to start the exercise to formulate SME standards with appropriate modifications in the light of the needs of users of SMEs and the purpose of financial reporting as outlined above.

BASIS FOR MODIFYING CONCEPTS AND PRINCIPLES FOR SMEs

As elaborated above the concepts or principles in full IFRSs must be modified on the basis of the identified needs of users of SME financial statements, cost-benefit analyses and the agreed upon purpose of financial reporting for SMEs. There needs to be empirical support for the formulation of the needs of users of SMEs. A suggestion would be to evaluate on a regional basis the prominent group of users of financial reports of SMEs in the region. Regional feedback will be useful for IASB in focusing on the needs of such users.

It is envisaged that it is likely that disclosures 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 disclosures for SMEs.

Therefore, it is important that IASB should not presume that no modification would be made to the recognition or measurement principles in IFRSs. As suggested above, the fundamental difference between the IFRSs and SME standards would be the identity of the user group. It follows logically that the purpose of financial reporting will differ for SMEs and hence it is not logical to start with the presumption that no modification would be made to the recognition or measurement principles in IFRSs. The key is to decide on the perspective that will inform the conceptualisation of financial reporting for SMEs, whether it will be "stewardship-accountability" perspective or "decision-usefulness" perspective or "informational-value" perspective that underlies current conceptual framework for IFRSs.

FORMAT OF PUBLICATION OF IASB STANDARDS FOR SMES

The IASB Standards for SMEs should be published in a separate printed volume. It is useful if it can be web- published to ensure easy access for all SMEs. The IASB Standards for SMEs should be organised in topical sequence such as integrated in a balance sheet-income statement line item sequence like the *UK Financial Reporting Standards for Smaller Entities (FRSSE)*. The reason being this will provide a comprehensive guide to the accounting personnel of SMEs (who in most instances are not qualified professional accountants, especially in the developing countries). We suggest the SME standards also indicate if there is a IFRS on that issue so that the SMEs can refer if need arises. Otherwise, SMEs may need to go through an ever increasing volume of IFRSs to determine which standards are applicable for SMEs. Further we anticipate there will be SME standards for which there are no equivalent IFRSs, for example, some procedural guidelines and Chart of Accounts and the like.

Each IASB standard for SMEs should include a statement of its objectives, a summary and a glossary of key terms as this will serve a purpose in enlightening SME stakeholders.

OTHER ISSUES

There are several concerns that arise from a CAPA (2003) that is highlighted here for consideration by IASB in formulating the SMEs standards.

• Involvement of SME stakeholders

SME stakeholders include among others these key players: the entrepreneurs (business owners), small and medium practitioners (SMPs) who provide accounting, auditing, taxation and other related services; the government, and lending agencies. The amount of involvement of the Big Four in SME affairs is negligible. Further, the SMPs are in turn not involved much in standard setting activities, either at the national level or at the international level, due to resource constraints.

Generally, the perception is that participation of SME stakeholders in the international standard setting process is minimal or almost absent. In order to obtain proper feedback from these groups, the IASB has to reach out to these. Even at national jurisdictions, the involvement of SME stakeholder groups is absent. Therefore, IASB has to ensure proper channels of communication and resort to harnessing the available resources at regional

levels to obtain grounded understanding of the SME users and their needs before a framework for SME Standards is devised.

- **Identifying users and Understanding user needs**

This issue is critical and thus far there is no evidence of in-depth studies to draw clear definitions of the user group and their needs. Studies at the national level are necessary to come to a common understanding of the needs and, hence, to derive a common purpose for financial reporting for SMEs.

- **Awareness of initiatives on SME standards**

The exploratory study (CAPA, 2003) reveals a lack of awareness of the issues of SMEs and the efforts by IASB to establish such standards. Clearly, national standard setters need to actively pursue initiatives to obtain SME stakeholder views and hold dialogues in their respective jurisdictions. Inevitably, it must be borne in mind that it is the developing countries that require the assistance of IASB and there is a greater need in such countries for SME standards. It is acknowledged in IASB's *Discussion Paper* that in some smaller or emerging economies, IFRSs are used as national GAAP for all or many unlisted companies, and therefore raising concerns of enforcement, suitability and cost-benefit issues. Sadly, concerted efforts on the part of both national standard setters and SME stakeholders to address issues relating to Standards for SMEs are clearly not evident in many countries.

Much focus needs to be directed at obtaining feedback from the relevant SME stakeholder representatives in order to ensure a viable strategy in formulating Standards for SMEs.

CONCLUSION

There has to be sufficient dialogue and awareness creation and stimulation of debates on this issue to ensure global acceptance. In this regard national standard setters and regional bodies for the accounting professions need to initiate and promote dialogues within its constituencies and ensuring concerns of relevant stakeholders are given due consideration.