



The South African Institute of Chartered Accountants

24 September 2004

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Paul Pacter
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Email: CommentLetters@iasb.org.uk

Dear Paul Pacter

PRELIMINARY VIEWS ON ACCOUNTING STANDARDS FOR SMALL AND MEDIUM SIZED ENTITIES

In response to your request for comments on the Discussion Paper – *Preliminary Views on Accounting Standards for Small and Medium Sized Entities*, attached please find the comment letter prepared by the South African Institute of Chartered Accountants (SAICA).

Comments have been received from several professional accounting bodies in South Africa, the South African Revenue Service and the Banking Council South Africa.

In respect of those issues on which there was not consensus, we have included more than one view in our response. Where a second view has been presented, it is supported by the banks who are concerned particularly at the loss of comparability.

We would like to thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Desrae Lawrence
Project Director – SMEs

cc: Frank Timmins (Chairman of the Limited Purpose Financial Reporting Committee)

Question 1a

*Do you agree that full IFRSs should be considered suitable for all entities?
If not, why not?*

View 1

The objective of financial statements, as set out in the IASB Framework for the Preparation and Presentation of Financial Statements, is relevant to most entities. Full IFRS are suitable for general purpose financial statements and should be applied by entities that are publicly accountable. For limited purpose financial statements the requirements of full IFRS should be relaxed, based on users needs and cost/benefit. Users include members, lenders and the tax authority.

A third tier of reporting should also be available to entities whose members do not require financial statements because they have access to all financial information, the entity has no borrowings and the only user of the financial statements is the tax authority. For such entities, a third tier of reporting possibly applying tax based accounting, should be used.

View 2

The fundamental principle underpinning IFRS is universality, common application and understanding of accounting standards throughout those countries that have adopted the standards. Any fragmentation, deviation or selective application of these standards will undermine that principle. Accordingly, full IFRS should be considered suitable for all entities.

Question 1b

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

View 1

The Board should develop a separate set of financial reporting standards for SME's. If the Board develops these standards, it would reduce the burden on national standard setters, many of whom lack the resources to develop high quality understandable standards for SMEs.

View 2

The IASB should not develop a separate set of financial reporting standards for SMEs. Such development would lead to the violation and erosion of the fundamental principles outlined in View 2, expressed in Question 1a.

If reporting requirements are to be reduced for SMEs, separate standards should not be developed. Instead, disclosure exemptions and recognition and measurement alternatives should be contained within each IFRS. This will maintain the linkage with full IFRS and facilitate updating when an IFRS is revised.

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?

IASB standards for SMEs should not be used by listed entities or other entities that are publicly accountable even if national law or regulation were to permit this. Financial statements for these entities should be prepared with the needs of a wide variety of users in mind and with the aim of achieving comparability between these entities. Full IFRS have been developed with this objective in mind and therefore full IFRS compliance is the only option that should be allowed for these entities.

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?

We agree that such entities adopting the IASB's standards for SMEs could not claim compliance with IASB standards for SMEs while not meeting the qualifying criteria.

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?

View 1

The objectives set out by the IASB are appropriate.

Consistent with View 2 expressed in Questions 1a and 1b, it is suggested that a great deal of progress towards meeting these objectives could be achieved through simplifying existing IFRS for all entities. The fact that there is a perceived need for simplified reporting is indicative that full IFRS reporting could be made more user friendly.

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 that the IASB should describe the characteristics of those entities for which it intends the standards to apply and also that it would be inappropriate to prescribe a quantitative size test. The IASB should also make allowance for each country to add to or change those characteristics to accommodate their unique circumstances.

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?

View 1

One set of standards should be prepared for all entities that are not publicly accountable, other than those in a third tier. A third tier of standards, possibly using tax based accounting, is appropriate to financial statements where the only user is the tax authority.

View 2

The concept of public accountability is somewhat elusive. A high degree of outside interest will be difficult to define objectively. The term 'essential public services', needs to be defined. Some entities may be classified as publicly accountable while others of the same size and nature of business may fall outside such classification, making comparison and evaluations difficult.

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?

View 1

Public accountability is the overriding characteristic that distinguishes general purpose financial statements from limited purpose financial statements. The principles and presumptive indicators are appropriate for applying the concept of public accountability, except for 3.3(d). Economic significance on the basis of criteria such as total assets, total income, number of employees and degree of market dominance, set out in 3.3(d), constitute a size test, which is inappropriate.

View 2

The principles in preliminary view 3.2 combined with the presumptive indicators in 3.3 would not constitute objective criteria for classification. The criteria specified are subjective and difficult to apply in practice. What constitutes a 'high degree of outside interest', an 'essential public service' and 'economically significant' are all subjective and elastic concepts that will be difficult to apply in practice. The IASB should make allowance for each country to add to or change those criteria to accommodate their unique circumstances.

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 minority shareholders need the protection that the above proposal provides. Other stakeholders, including the banks and the tax authority, should also be considered.

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?*

It is appropriate that financial statements of entities that are part of a group should be consistently prepared. If one member of the group is subjected to full IFRS reporting, all members should be expected to comply with the full requirements of IFRS.

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?*

It should be mandatory for each entity to look to the appropriate IFRS to resolve an issue not addressed in the IASB Standards for SMEs. This will assist in retaining comparability and eliminate tax planning opportunities. However, a need to refer to full IFRS to resolve an issue would demonstrate that IASB Standards for SME's are not a complete set of standards.

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?*

View 1

An SME should be permitted to revert to an IFRS if the treatment in the SME version of the IFRS differs from the treatment in the IFRS. This is consistent with the view that SME standards should be formatted as allowed exemptions from disclosure requirement of full IFRS and allowed alternatives to recognition and measurement requirements of full IFRS.

View 2

An SME should be required to choose either the complete set of IFRS or the complete set of SME standards with no optional reversion. This is necessary to achieve comparability.

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?

If reversion to an individual IFRS is permitted, it should be on a standard by standard approach. Allowing reversion to IFRS on a principle by principle approach is more likely to create inconsistencies within financial statements.

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?

The best approach would be to leave the fundamental concepts from the Framework and the principles of IFRS undisturbed. Modifications to each IFRS could comprise disclosure exemptions and allowed alternatives to recognition and measurement. It is important that any modifications should significantly ease the financial reporting burden on smaller entities.

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?

View 1

Any modifications for SMEs to the concepts or principles in full IFRS could be on the basis of identified needs of users of SME financial statements or a cost/benefit analysis. The main users of SME financial statements are the members, lenders and the tax authority. Modifications must not be such that lenders frequently require entities to revert to full IFRS or alternately raise the cost of borrowing to compensate for increased risk. Tax authorities often refer to IFRS compliant financial statements as a starting point to calculate taxable income. Amendments to the recognition or measurement criteria should not create tax planning opportunities. Consideration of the needs of members, lenders and the tax authority as well as cost/benefit assumptions requires consultation and the exercise of judgement.

View 2

The principles in IFRS should not be modified either by perceived user needs or by cost/benefit assumptions. Simplification should not sacrifice principles, but should result in standards that are more user friendly. It is difficult and subjective to set the parameters for a 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?

We agree that disclosure and presentation modifications should be justified on the basis of user needs and a cost/benefit analysis. Full IFRS disclosure requirements should be the starting point, with selective allowed alternatives to these requirements 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 a cost/benefit analysis?

If not, why not?

View 1

Recognition and measurement principles in IFRS should be modified on the basis of user needs and a cost/benefit analysis.

View 2

There should be no modification to the recognition or measurement principles in IFRS irrespective of user needs or cost considerations, as this detracts from comparability and fair presentation.

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.

IASB standards for SMEs should be published in separate sections of each IFRS. This would make the differences more readily apparent, facilitate reference to full IFRS for transactions not addressed by the IASB standards for SMEs and facilitate education, training and development of accounting software. However, if changes are extensive, a separate printed volume should be published.

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.

We agree that IASB standards for SMEs should be organised by IAS/IFRS number. Any other approach might create confusion, particularly for users of both sets of standards.

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?

We agree that a statement of the objective, a summary and a glossary of key terms should only be included if the IASB standards for SMEs are printed in a separate volume.

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?

- The term 'small and medium sized entities' should be changed to 'limited purpose financial reporting entities'.
- It is important to focus on public accountability as it is the overriding characteristic that distinguishes general purpose financial statements from limited purpose financial statements. Size is not a criterion.
- The IASB standards for SMEs should not provide too little information, so that minority shareholders cannot reasonably make a decision to hold or disinvest, thus forcing the SME to comply with full IFRS.
- The IASB should make allowance for a third tier of reporting for entities for which the members do not require financial statements, because they have access to financial information, the entity has no borrowings and the only user of the financial statements is the tax authority.
- Public accountability criteria should be left to each country to accommodate their unique circumstances.
- The IASB should consider first time adoption and transitional provisions.