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Mr Paul Pacter  
Director of Standards for SMEs  
International Accounting Standards Board  
30 Cannon Street  
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7 October 2004

Dear Paul

**IASB Discussion Paper: Preliminary views on accounting standards for Small and Medium Sized Entities**

The Accounting Standards Board is grateful for the opportunity to comment on the above discussion paper.

The Board welcomes the IASB's initiative and the presumption that there should be financial reporting standards for SMEs. The positive experience of the Financial Reporting Standard for Smaller Entities (FRSSE) in the UK and Republic of Ireland has shown the value of establishing a credible, simplified financial reporting regime for smaller entities and should provide a useful precedent for the IASB in taking forward its work in this area.

While the IASB's two primary objectives for undertaking this project – to reduce the burden on preparers and meet the needs of users – are commendable, the IASB should aim to produce standards for SMEs that are as concise as possible. The guiding aim should be to achieve a significant reduction in the burden of application of IFRS for entities within the scope of the project. The IASB should focus on smaller companies when developing detailed proposals.

The discussion paper proposes mandatory fallback to IFRS for any particular accounting issue that is not addressed in the SME standards. The Board would prefer the alternative approach considered in the discussion paper which is based on the hierarchy approach set out in IAS 8. Reference to IFRS would be a means of establishing generally accepted practice rather than the only one (Question 4).



The use of optional reversion to full IFRS (either standard by standard or principle by principle) should be carefully defined. In the absence of example SME standards it is difficult to envisage the impact of the proposals and therefore comment substantively on this aspect. If implemented, the IASB will need to guard against unacceptable use which could give rise to an undesirable 'pick and mix' selection of full IFRS and SME standards (Question 5a).

The Board believes that subsidiaries, joint ventures and associates of publicly accountable entities should be entitled to use SME standards. There should be some easement of reporting requirements for subsidiaries in those cases where most user needs are already met through the consolidated accounts. This matter should be determined by national jurisdictions (Question 3e).

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Despite the concerns noted above, the Board is encouraged by the discussion paper. It has the merit that it starts from the presumption that there will be financial reporting standards for SMEs and has taken readers through the thought processes. The Board is gradually converging its financial reporting standards with those of the IASB. The Board supports the concept of the development of global standards for SMEs and has recently stated (ASB Discussion Paper - UK Accounting Standards: A strategy for convergence with IFRS) that it hopes the IASB project will produce a set of requirements that will provide a suitable basis for the replacement of the UK FRSSE.

We hope that the responses to the discussion paper will assist the IASB in refining its approach so that the accounting standards for SMEs will be suitable for this purpose.

If you would like further clarification of the points raised in this letter please contact either Duncan Russell (020 7611 9716) or myself on 020 7611 9701.

Yours sincerely

Ian Mackintosh

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

The Board believes that any entity should be able to use full IFRS for the preparation of its financial statements if it so chooses.

Full IFRSs have been developed primarily for use in international capital markets so that financial statements provide financial information about an entity that is useful to a wide range of users in making economic decisions. However, for most smaller entities, it may be appropriate for greater emphasis to be given to the need for financial statements to show the results of the stewardship or accountability of management. There is no active market in smaller entities' shares and thus members and users are not making day by day economic decisions to buy, sell or hold the shares. They tend rather to use the information as an annual check. Therefore the IASB should give more emphasis to stewardship when developing standards which are designed to fit the needs of users of SME financial statements.

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

The Board welcomes the development of separate guidance for SMEs. Practical experience in the UK suggests that this is what actually works for smaller entities and is best delivered through a single, separate document.

*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?*

The Board agrees that it would be undesirable for publicly listed entities to use IASB standards for SMEs. If they did, their financial statements should not be described as being in compliance with SME standards. The Board supports preliminary view 1.3 that the basis of presentation should be disclosed in the notes to the financial statements and the auditor's report.

*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?*

The Board supports objectives (a) to (d) for IASB standards for SMEs set out in preliminary view 2 in the Discussion Paper, but does not believe that objective (e) of allowing easy transition to full IFRS is necessary. Retaining this objective might restrict the simplification of SME standards to suit larger companies as these will tend to be the entities making the transition to public listing.

For those companies seeking a prospective listing, the best approach is to move to full reporting standards in advance of listing. Companies which do go public will be required by the listing authorities to provide appropriate track record information which in many cases will involve application of full IFRS from an earlier date.

*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?*

The Board agrees that the IASB should describe the characteristics of the entities for which it intends the standards to apply. However, whilst the IASB may not wish to prescribe 'quantitative' size tests, it is important for the IASB to be clear in its own mind about the target entity size range for its SME standards. Without this view, there would be a risk of the standards' design gravitating to the larger end of the spectrum. It would be regrettable if the result of the approach were full IFRS for listed entities with the SME standards for all other non-listed entities. If this were to happen, there is a risk that the needs of smaller entities would not be catered for and so national jurisdictions would develop or continue with their own rules for SMEs. In the UK and the Republic of Ireland the focus of the FRSSE is on smaller entities as defined in company law derived from the EC Directives.

*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?*

The Board does not support this view. In terms of economic significance, companies at the larger end of this particular spectrum are an important constituency and the IASB should provide an appropriate accounting regime such as full IFRS. As noted in the response to question 3a, there is a risk that the preferred approach will not meet the needs of smaller entities. The IASB will still need to address the reporting burden on smaller entities – otherwise it will fall to national jurisdictions to fill the gap. This would give rise to three tiers of standards, full IFRS, IFRS for SMEs as defined by the IASB and local requirements for the smallest entities.

*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?*

The Board agrees that the preliminary views regarding the public accountability principle and the presumptive indicators of public accountability provide a workable definition.

*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 objects to the entity's preparing its financial statements on the basis of IASB Standards for SMEs. If not, why not?*

The specific requirement proposed - the consent of all owners - is too onerous. This is likely to preclude a number of entities from adopting IFRS for SMEs. A higher or simpler threshold should be devised. This may be a matter that is left to national jurisdictions.

*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?*

We disagree. The Board believes that subsidiaries, joint ventures and associates of publicly accountable entities should be entitled to use SME standards. There should be some easement of reporting requirements for subsidiaries in those cases where most user needs are already met through the consolidated accounts. This may be a matter that is better dealt with by national jurisdictions.

*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?*

The Board does not agree with the proposal in preliminary view 4 for mandatory fallback to full IFRS where an SME standard does not address a particular accounting issue. We would prefer the alternative approach considered in the discussion paper which is based on that set out in IAS 8. Reference to IFRS would then be a means of establishing generally accepted practice rather than the only one.

*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?*

In the absence of example SME standards it is difficult to envisage the impact of the proposals and therefore comment on this aspect.

It would seem to be concerning if there were sufficient differences in measurement and recognition requirements between the two sets of standards for this issue to arise often. If implemented, the use of optional reversion to full IFRS (either standard by standard or principle by principle) should be carefully defined. The IASB will need to guard against unacceptable use which could give rise to an undesirable 'pick and mix' selection of full IFRS and SME standards.

*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)*
- (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.*

As noted above, the Board does not support optional reversion to 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?*

The Board appreciates that this is a practical way to develop SME standards. However, the IASB should be innovative in developing a product that is helpful and meets the needs of 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?*

The Board agrees that the identified needs of users of SME financial statements are appropriate bases for the modification to the concepts or principles in full IFRS. The Board acknowledges that consideration of the costs to preparers against the benefits to users also has its place. However, the Board recognises that reliable cost/benefit calculations are seldom possible. The need for standards has to be assessed in terms of the significance and extent of the problem being addressed and the treatment which appears to be most effective in cost/benefit terms will be chosen.

*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?*

The Board agrees it is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost-benefit analyses. Experience in the UK suggests it is likely that the disclosure modifications would decrease the current level of disclosure.



*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?*

The Board agrees that this is a reasonable presumption, although it might be rebutted in some cases.

*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 Interpretation) or some other approach, please explain why.*

The Board agrees with the view to publish the SME standards in a separate printed volume to re-enforce the separate identity of the standards and to provide a convenient form of reference.

*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.*

The Board disagrees with the view that IASB standards for SMEs should be organised by IAS/IFRS number. This will perpetuate the feeling of a top-down document. The Board's experience suggests that preparers and users appreciate the integrated presentation of standards in a topical sequence as this provides a practical means to access all relevant reporting requirements in one place. A derivation table could be developed to provide the link back to individual full standards if reference to them is required.

*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?*

The Board agrees that a glossary of key terms is important. It questions the need for a statement of objective and a summary in each standard. This will add to the volume of the reference material. If the standards or the standard ordered in a topic sequence are crisply written, summaries and separate objectives for each should be unnecessary.

*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?*

If the IASB wishes to develop detailed proposals based on the current definition of entities that are not 'publicly accountable' it would be more appropriate for the project not to refer to 'small and medium sized entities', as this description is likely to raise expectations that may not be met.