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Dear Paul

IASB DISCUSSION PAPER – PRELIMINARY VIEWS ON ACCOUNTING STANDARDS FOR SMALL AND MEDIUM-SIZED ENTITIES

The Institute's Accounting Standards Committee has considered the above Discussion Paper and I am pleased to set out its comments below.

The Committee is in general highly supportive of financial reporting standards for SMEs. It has been involved in research on this topic for the UK Accounting Standards Board in the past in connection with that Board's development and updating of its Financial Reporting Standard for Smaller Entities. This research included studying the implementation of the FRSSE by companies which found that it was being widely used by those companies eligible to apply the standard.

The Committee's preference is for an approach which retains the recognition and measurement criteria of full IAS/IFRSs, while reducing the amount of detailed disclosure required for small entities. This approach helps to avoid confusion regarding the principles under which financial statements have been prepared and makes the transition from SME accounts to full IAS/IFRS accounts relatively straightforward, with only additional disclosures being required, rather than a change in recognition and/or measurement rules. As international standards for SMEs are developed, the Committee is keen to see this approach adopted.

Response to Detailed Questions

Our responses to the specific questions in the Discussion paper are set out below:

Issue 1. Should the International Accounting Standards Board (IASB) develop special financial reporting standards for SMEs?

Preliminary view 1.1 – Full IFRSs are suitable for all entities. *The objective of financial statements as set out in the IASB framework is appropriate for SMEs as well as for entities required to follow full IFRSs. Therefore full IFRSs should be regarded as suitable for all entities. (“Full IFRSs” are standards and interpretations adopted by the IASB. They comprise International Financial Reporting Standards, International Accounting Standards and Interpretations originated by the International Financial Reporting Interpretations Committee or the former Standing Interpretations Committee.)*

Preliminary view 1.2 – The Board will develop standards for SMEs. *The Board will develop a set of financial reporting standards that is suitable only for those entities that do not have public accountability (“IASB Standards for SMEs”). Those standards would not be intended for use by publicly accountable entities, including those whose securities have been listed for trading in a public securities market, even if national law or regulation were to permit this. Public accountability is discussed in issue 3 and preliminary views 3.1 – 3.6.*

Preliminary view 1.3 – disclose the basis of presentation. *If an entity follows IASB Standards for SMEs, the basis of presentation note and the auditor’s report should make that clear.*

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

We do not agree that full IFRSs should be considered suitable for all entities. We strongly support the idea of helping small and medium-sized entities by bringing standards to them in a single easy to follow document.

(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 with this proposal.

(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 IASB does not have the authority to over-ride national law. Rather, it is up to national regulators to determine what is appropriate for their local jurisdiction even if this involves allowing publicly listed or other entities to use the IASB standards for SMEs. We consider that this may particularly be the case for national regulators and entities in developing economies.

Issue 2. What should be the objectives of a set 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 on SMEs that want to use global standards; and
 - (e) allow easy transition to full IFRSs for those SMEs that become publicly accountable or choose to switch to full IFRSs.
- (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?

Yes, we agree with the objectives. However, we consider that the existing IASB Framework needs to be redrafted and its status enhanced. With regard to point (d) above we would like to see a burden for SMEs that is relevant, appropriate and proportionate and is commensurate with the obligations that they face.

Issue 3. For which entities would IASB Standards for SMEs be intended?

Preliminary view 3.1 – No size test. The Board should describe the characteristics of the entities for which IASB standards for SMEs are intended. Those characteristics should not prescribe quantitative “size tests”. National jurisdictions should determine whether all entities that meet those characteristics, or only some, should be required or permitted to use IASB standards for SMEs.

Preliminary view 3.2 – Public accountability principle. Public accountability is the overriding characteristic that distinguishes SMEs from other entities. Full IFRSs, and not IASB Standards for SMEs, are appropriate for an entity that has public accountability. An entity has public accountability if:

- (a) there is a high degree of outside interest in the entity from non-management investors or other stakeholders, and those stakeholders depend primarily on external financial reporting as their only means of obtaining financial information about the entity; or
- (b) the entity has an essential public service responsibility because of the nature of its operations.

Preliminary view 3.3 – presumptive indicators of public accountability. A business entity would be regarded as having public accountability, and therefore should follow full IFRSs, if it meets any of the following criteria:

- (a) it has filed, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market;
- (b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment banking entity;
- (c) it is a public utility or similar entity that provides an essential public service; or
- (d) it is economically significant in its home country on the basis of criteria such as total assets, total income, number of employees, degree of market dominance, and nature and extent of external borrowings.

Preliminary view 3.4 – Required assent of all owners. *An entity that does not satisfy any of the presumptive indicators of public accountability would nevertheless be regarded as having public accountability unless it has informed all of its owners, including those not otherwise entitled to vote, that it intends to prepare its financial statements on the basis of IASB Standards for SMEs rather than on the basis of IFRSs, and none of those owners object to using IASB standards for SMEs.*

Preliminary view 3.5 – Scope: all entities that do not have public accountability. *The Board intends to include all entities that do not have public accountability as potential adopters of IASB standards for SMEs.*

Preliminary view 3.6 – Subsidiaries, joint ventures and associates. *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 the parent, venturer or investor, it should comply with full IFRSs, not IASB Standards for SMEs, in its separate financial statements.*

- (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 with this proposal. However we believe that there is a need for consistency between the views set out in preliminary view 3.1 and question 1(c) regarding the power of national jurisdictions. Preliminary view 3.1 notes that national jurisdictions should determine which entities should be required or permitted to use IASB Standards for SMEs whereas question 1(c) implies that the Board could over-ride national regulators.

- (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?*

Yes, although the IASB should be wary of imposing an Anglo-Saxon view of public accountability. The concept of public accountability needs to be interpreted in the context of the culture of the countries concerned.

- (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?*

Yes but the application must allow real flexibility for national needs. We believe that it is up to national governments to determine whether companies need to comply and that the IASB may give recommendations only. We believe that in order to encourage compliance with IASB Standards for SMEs, national governments should not have significant restrictions placed on them. We suggest that the IASB make their product readily available to potential users and do all it can to encourage such users. The SME cause will not be helped if the IASB places excessive restrictions on use of the standards.

- (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 disagree with this proposal. We believe that it would be inappropriate for a single shareholder to be able to force an entity to follow full IFRSs.

- (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 do not agree with this proposal if the subsidiary would otherwise be able to prepare its separate financial statements using IASB standards for SMEs. It would be unduly onerous to impose a requirement to use full IFRSs in such situations.

Issue 4. If IASB Standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, how should that entity resolve the issue?

Preliminary view 4 – Mandatory fallback to IFRSs. *If IASB standards for SMEs do not address a particular accounting recognition or measurement issue that is addressed in an IFRS, the entity would be required to look to that IFRS to resolve that particular issue only. The entity would continue to use IASB Standards for SMEs for the remainder of its financial reporting. Each IASB Standard for SMEs should explicitly mention the required fallback to IFRSs.*

- (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?*

We do not agree with this proposal. We believe that if a particular issue is not addressed in the standards for SMEs, an entity should be able to revert to the Framework and principles from the full standards rather than having to apply the full standards themselves. In terms of paragraphs 42 and 43 of the discussion paper, we prefer the approach taken in the United Kingdom to that taken in Canada. However, for this to be possible a more robust Framework would be required. We also agree with the views expressed in paragraph 45 of the discussion paper. In order for our preferred approach to be workable, it will be necessary for all the basic principles of the full standards to be included in the SME standards so that entities can look at the principles rather than reverting to the full standards. We would therefore be concerned if the principles from the full standards were to be omitted from the SME standards as we believe that these principles need to be fully reflected in the SME standards.

Issue 5. May an entity using IASB Standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB Standard for SMEs?

Preliminary view 5 – Optional reversion to an IFRS. *If an IASB Standard for SMEs provides an exemption or simplification from a recognition or measurement requirement in the related IFRS, an entity that uses IASB Standards for SMEs would not be prohibited from applying the related IFRS in its entirety, while otherwise continuing to use IASB Standards for SMEs. Optional reversion would not be permitted for only some, but not all, principles in the related IFRS.*

- (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 believe that entities should be required to choose either the full standards or the SME standards. However, we would not prevent entities from giving additional disclosure. As noted above, we do not support having different measurement and recognition rules between the full standards and the SME standards so this question should in principle be irrelevant. As such, we would like to point out that we consider that Examples 5D and 5E in the discussion paper are inappropriate as we do not agree with the concept that measurement rules can change.

- (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?

As noted in our response to question 5(a) above we believe that the SME standard should reflect the complete principles of the full standard and accordingly this question should in principle not be relevant.

Issue 6. How should the Board approach the development of IASB Standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?

Preliminary view 6 – IFRSs are the starting point for developing SME standards. *Development of IASB Standards for SMEs should start by extracting the fundamental concepts from the IASB Framework and the principles and related mandatory guidance from IFRSs (including Interpretations).*

- (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 with the proposal that development of SME standards should start with the concepts and principles but are not sure that the related mandatory guidance should also be included in this process.

Issue 7. If IASB Standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?

Preliminary view 7.1 – Justification for modifications. *Any modifications to the concepts or principles in IFRSs must be based on the identified needs of users of SME financial statements or cost-benefit analyses.*

Preliminary view 7.2 – Likelihood of disclosure and presentation modifications. *It is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost benefit analyses. The disclosure modifications could increase or decrease the level of disclosure relative to full IFRSs.*

Preliminary view 7.3 – Rebuttable presumption of no recognition and measurement modifications. *There would be a rebuttable presumption that no modifications would be made to the recognition and measurement principles in IFRSs. Such modifications can be justified only on the basis of user needs or cost-benefit analyses.*

- (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?*

We note that in this question modifications must be on the basis of user needs *or* cost-benefit analysis whereas question 7(b) below refers to modifications being justified on the basis of user needs *and* cost-benefit analyses. We believe that this represents a significant difference. In this question we believe that any decision should be based on user needs rather than cost-benefit analysis alone and therefore suggest that the use of an either/or scenario in this question is inappropriate. We also suggest that concepts and principles would not be modified but that applications may be. In connection with this, we believe that the examples given in the discussion paper are all modifications of presentation and disclosure rather than principles. We further believe that this should not be an issue if question 6 has been addressed properly.

- (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 with this proposal although we would suggest that a strong focus on user needs is required.

- (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?*

We agree with this proposal and therefore believe that question 7(a) is redundant.

Issue 8. In what format should IASB Standards for SMEs be published?

Preliminary view 8.1 – Separate volume. *IASB Standards for SMEs should be published in a separate printed volume. The Board may also use other means of publication, such as Web publishing.*

Preliminary view 8.2 – Organised by IAS/IFRS (and Interpretation) number. *IASB Standards for SMEs should:*

- (a) *follow the IAS/IFRS (and Interpretation) numbering system – i.e. SME-IAS 1, SME-IAS 2 etc and SME-IFRS 1, SME-IFRS 2 etc; and*
- (b) *not be reorganised by topic, such as integrated in a balance sheet-income statement line item sequence like the UK Financial Reporting Standard for Smaller Entities (FRSSE).*

Preliminary view 8.3 – Foreword material in each Standard. *Each IASB Standard for SMEs should include a statement of its objective and a summary.*

- (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?*

We agree with this proposal. We would also like to suggest that updates to the standards, whether in printed or electronic format, should only be done annually as otherwise we are concerned that it would prove extremely difficult for developing countries to keep up to date with the standards, particularly when it is necessary for the standards to be translated into other languages.

- (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?*

While we believe the idea of topical sequencing is good, we recognise that for it to work properly, extremely good cross-referencing would be required. Also, we believe that it could prove difficult to identify globally recognisable topic names. We therefore believe that it would be best to follow the numerical sequence of full IAS/IFRSs. We believe that this would make it easier to refer back to the full standards if necessary and also to move to full standards from SME standards. However, if a numerical sequence is followed, we believe that a good topical index to the SME standards would be essential.

- (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 with this proposal.

- (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?*

We believe that the Board should investigate what it can do to bring out the importance of narrative reporting. As noted above, ICAS has been involved in the past in previous research into financial reporting standards for smaller entities and the benefit of increasing narrative reporting in financial statements is a point that we would like to see emphasised.

If you wish to discuss our comments further, please do not hesitate to contact me.

Yours sincerely

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