CL 67

01 October 2004

Paul Pacter
Director of Standards for SMEs
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

75 Cannon Street
London EC4N 5BN
Tel. 020 7556 7053
Fax 020 7556 7520
E-mail: LSCA@icaew.co.uk

Dear Mr Pacter

Preliminary views on accounting standards for small and medium-sized entities

1. With a membership of in excess of 37,000, the London Society of Chartered Accountants (LSCA) is the largest of the regional bodies that form the Institute of Chartered Accountants in England & Wales. London members, like those of the Institute as a whole, work in practice or in business. The London Society operates a wide range of specialist committees including Technical (accounting and auditing), Tax, Regulation and Ethics Review and Financial Services and Insolvency, which scrutinise and make representations to issuing bodies such as yourselves.

2. We are pleased to have the opportunity to comment on IASB's preliminary views in relation to this issue.

Overall comments

We strongly support the IASB's initiative in taking up this project and giving it the resources to progress. Developing a global set of standards for SMEs is an important project because of the size of the SME sector and because of the diverging financial reporting needs of listed and other publicly accountable entities on the one hand and SMEs on the other. In our answer to Question 1b below, we have indicated a number of useful roles such a set of standards could fulfil.

Responses to specific questions

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

We disagree that full IFRS would form a suitable set of accounting standards for SMEs. The average SME does not engage in such complex transactions or in such a range of transactions. Measurement bases may be more complex and costly than the users need or the benefits justify. The disclosures demanded are often in excess of those needed by the users of SME financial reports. The length and complexity of full IFRSs means that they are harder and more costly to understand and use for SMEs and therefore as a system of accounting standards they are not suitable for SMEs.

We agree, however, that if an individual SME chooses to use full IFRSs its resulting financial statements should achieve a fair presentation.

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

Yes, we agree that the Board should develop a separate set of financial reporting standards suitable for SMEs. SMEs (however these are defined) are a very important sector, accounting for the vast bulk of number of reporting entities and for the bulk of economic activity. For the reasons noted in our answer to Question 1a above we consider the full IFRSs are not suitable for SMEs.

On the other hand we do think that a global set of standards for SMEs would assist

- in countries where resources are insufficient for independent national standard setting
- in the convergence of financial reporting within a country like the UK where full IFRSs are being applied by listed companies
- those SMEs engaged in cross-border activity by making their financial statements more readily understandable

Given these likely uses of IASB's SME standards, the absolute comparability of financial statements between entities though desirable would not be of such overriding significance as with the financial statements of listed companies used by global investors.

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?

We agree that IASB Standards for SMEs should not be used by publicly listed entities because they would not be relevant to the needs of users of listed entities.

On the second question we disagree. It seems to be simply a matter of fact as to which set of standards (rightly or wrongly) have been used.

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?

(a) provide high quality, understandable and enforceable accounting standards suitable for SMEs globally:

We generally agree. With reference to 'understandable', the levels of understanding and familiarity with accounting concepts and policies of the users of the financial statements of SMEs will generally be less than those of listed companies.

(b) focus on meeting the needs of users of SME financial statements

We agree with this objective

(c) be based on the same conceptual framework as IFRSs

We agree. The Framework, however, is in places too oriented to large listed companies and the explanatory text and the balance given to different factors might need to be adjusted. We would not see any reason, for example, to change the definitions of the elements of financial statements. We have noted above that comparability between entities might need to be given a lesser weighting when drawing up SME standards. The various potential uses of the financial information might be the same between SME and listed company accounts, the relative importance of those different uses might not be the same – as set out in Paragraph 6 of the Discussion Paper.

(d) reduce the financial reporting burden on SMEs that want to use global standards

We agree with this objective.

(e) allow easy transition to full IFRS's for those SMEs that become publicly accountable or choose to switch to full IFRS

While in principle we would not want to raise difficulties for any such transition, we note that the number of SMEs which become publicly accountable are so very small that this issue should not be an important factor in developing 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?

IASB needs to establish criteria that will be useful in setting appropriate standards. It will, as the Discussion Paper notes, be up to national jurisdictions to decide exactly which entities should be allowed to use those standards in practice. Clearly national jurisdictions in doing so, would benefit from IASB guidance to set their thresholds and definitions.

We agree that IASB needs qualitative criteria and these should include whether the company is listed or not, as well as a test of economic significance. IASB should not risk that their set of SME standards will be too elaborate and too similar to full IFRSs to be of much help to the vast bulk of SMEs, which are small entities.

Question 3b. Do you agree that the Board should develop standards that would be suitable for <u>all</u> 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?

In our view the IASB should try to address the needs of all SMEs. This means writing standards that are appropriate for the average SME, which in most economies would be quite a small company. IASB should not be trying to write the SME standards so that the issues of large unlisted companies are covered. The SME standards should not be appropriate for them and national jurisdictions should be encouraged to require them to follow full IFRSs instead.

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 do not agree that this is workable. In our view the Board is getting involved with the details of the definitions more than is necessary to set the standards. The detail of precisely which companies should be allowed to use the SME standards must be left to national jurisdictions.

Only the first of the principles is needed in our view, that is paragraph 28(a), and 28(b) is not needed. Entities involved with significant public services would qualify under the first principle anyway.

In terms of the four presumptive indicators, we agree with (a) and (d). The others, financial fiduciaries and public service entities, are not needed by IASB, but these might well be included in a definition, determined by national jurisdictions, of which companies must employ full IFRS.

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?

This is again a matter which should be left by IASB to national jurisdictions, and also one which does not in any way affect the *setting* of the standards which is IASB's role.

We disagree that an entity should be required to use full IFRSs if one or more of the owners of its shareholders object to the entity's preparing its financial statements on the basis of IASB for SMEs. The existence of one non-assenting shareholder does not in our view create public accountability as defined in the principle, nor is it consistent with the other presumptive indicators. For example Paragraph 29 of the Discussion paper in explaining the principles refers to "a substantial group of persons".

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. While most subsidiaries, associates or joint ventures in such cases would probably not go to the trouble of preparing a different set of accounts based on SME Standards, we see no reason for the IASB to say that they cannot. This would seem especially the case where the consolidated financial statements of the group or of the investing entity are available on the public record.

In principle public accountability should be a quality to be judged in relation to the particular reporting entity, and should be unaffected by the status of an entity investing in it.

This again seems a matter which should be left to national jurisdictions and does not affect in any way the *setting* of the standards by IASB.

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?

We find this difficult to answer as we are not sure what "look to" means. Is the full IFRS meant to be guidance or must all of the recognition and measurement provisions to be followed? The examples 4A and 4B do not help much because 4A says "… look to the full version of IAS19 for guidance" while 4B states "… required to comply with the hedge accounting requirements of IAS39".

That said we prefer the approach set out in Paragraph 41(b) as compared to that in 41(a). The Board is intending to develop SME versions of the full standards and we presume that this will cover most full IFRSs. This mandatory fall back is only important where an IFRS or an interpretation has not been covered and this seems most likely to be the case where the subject is relevant to very few SMEs. This would not make its recognition and measurement treatment necessarily appropriate 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?

We support optional reversion, subject to certain limitations, to an IFRS if the treatment in the SME version of the IFRS differs from the treatment in the IFRS. Those restrictions would be that reversion would not be possible where there was a specific prohibition on the treatment in the SME version or the treatment chosen would be inconsistent with other treatments in the SME standards. If any extra disclosure requirements were mandated by the SME standards these should not be avoided by reverting to full IFRS.

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?

An SME 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). We would require that the precise extent of any optional reversion is clearly disclosed. We accept that comparability might be reduced as a result, but as we have noted above (under Question 1b) we consider that this factor should be given lesser weight in developing SME standards.

As noted in the discussion paper the issue is only of importance in relation to recognition and measurement differences. If preliminary view 7.3 is sustained then the extent of these are likely to be limited.

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. However, it is important to ensure that IFRSs are applied to take account of the characteristics of 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?

We agree. Any modifications for SMEs to the concepts and principles in full IFRSs must first be on the basis of identified needs of the users of financial reports produced for SMEs, followed by a cost benefit test.

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. While in principle we agree that the disclosures could be increased or decreased, in practice we would expect that the instances of increases, if any, would be few and far between.

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?

We disagree. As noted above (Question 7a) the SME standards should be based on IFRS and decisions on recognition and measurement differences should be based on user needs and the cost/benefit question. We see no reason, however, to make a presumption of no modifications. Indeed we would expect that there would be some such differences. We appreciate that Examples 5A to 5D are phrased as hypothetical, but they are potentially the sorts of difference that would be appropriate.

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.

We agree that the IASB Standards for SMEs should be published in a separate printed volume. The experience of the use of the FRSSE in the UK is that the single volume approach is helpful.

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.

IASB Standards for SMEs should be in topical sequence with a cross reference to the relevant full IFRS. A topical sequence is more logical and would be easier to use and understand.

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 do not agree. Given our preference for a single volume in topic order, we would not see any reason for such stand-alone individual standards. A single glossary would be more helpful for the users than several. The topics we expect would be able to be dealt with in a fairly concise and straightforward manner, which would not require a summary.

We hope that you have found our comments helpful. Should you wish to discuss them further please contact the author of this response, Richard Martin on 020 7396 5748, or contact me on at the address above or on 020 7220 3231.

Yours sincerely

Steven Brice
Deputy Chairman, LSCA Technical Committee