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**To: IASB**

***Paul Pacter, Director of Standards for SMEs***

**CC:**

**Date: 12/9/2004**

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**Following are my comments on the Discussion Paper "Preliminary Views on Accounting Standards for Small and Medium-sized Entities".**

**Issues not commented below should be understood as getting a "yes" answer to the "Do you agree..." formulation.**

<b><u>ISSUE 1 - Question 1c</u></b>
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One cannot prohibit someone from disclosing a logically true and truthful statement. So if an entity having "public accountability" uses IASB standards for SMEs and not full IFRSs as it should, then its financial statements **are** in compliance with IFRSs for SMEs and they have an "absolute right" to be described as such. It's an entirely different matter that the entity should follow full IFRSs instead.

**Recommendation**

Eliminate the prohibition, and insert a requirement in **Preliminary View 1.3**, that follows the principle "guilty until proven innocent".

All entities applying IASB standards for SMEs should justify in full and in detail why they do not have "public accountability" to their point of view. **More over this justification should be presented on the face of the balance sheet.**

If an entity does have "public accountability" as defined, it will thus be forced to state an outright, bland, directly public and easily checked lie, in order to use the SMEs Standards. That's a self-control preventive mechanism that will deter most would-be "offenders". The rest will be far engaged in economical falsification and unethical conduct, and no amount of IASB restrictions would stop them anyway.

<b><u>ISSUE 3 - Preliminary view 3.1</u></b>
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Although it is not posed as a question, **I strongly disagree with the sentence "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"**. That's a window for unacceptable discretion at the national level. At best, it is an unnecessary statement.

As with full IFRSs, IASB should stand firmly by its own principles and leave no doubt that entities wishing to apply IASB standards and **publicly state so in order to enjoy the international respectability that goes along with those standards**, should follow IASB rules. The above sentence would permit an entity having "public accountability" under IASB rules, to report under SME's standards because of national law, and to "hide" behind this law (this is, it seems, the situation that question 1c tried to accommodate, albeit in an awkward way as commented above).

**Recommendation**

Eliminate the sentence. Moreover, perhaps here is the most appropriate placement of the recommendation I made earlier while commenting on question 1c (assuming of course that my recommendation will be accepted!).

**ISSUE 3 - Question 3c**

The principles in Pr.V. 3.2 combined with the presumptive indicators of public accountability in Pr.V. 3.3 do provide a workable definition – **but not appropriate guidance**. The issue should be further detailed, without entering into “size tests” (the exclusion of which from IASB prescriptions I support -although an entity should be permitted to use size tests in order to justify its own assessment of whether it has public accountability or not).

The main problem has to do with criterion (c) and it stems from the deregulation of the markets for “essential public services”.

Due to this deregulation, small companies acting purely as resellers and middlemen have entered these markets, eg. in the telecommunications industry where a lot of small businesses resell Voice services, essentially provided by the assets and infrastructure owned by the big players of the market.

These companies would be described as having public accountability, even if they do not fall under criterion (d), just because the nature of the service they provide is considered “essential public service”, and so they satisfy criterion (c) in a narrow sense. But such companies do not really enter the realm of public accountability – they are easily and costlessly replaced by their competitors or the big players themselves. So public prosperity is not jeopardized by their fortunes.

**Recommendation**

Insert the essence of criterion (d) in criterion (c) while keeping also criterion (d) as a separate indicator for companies of other activities.

Therefore criteria (c) and (d) could read something like

<< **(c)** it is a public utility or similar entity that provides an essential public service **and is economically significant as defined below in criterion (d) or (d) irrespective of the nature of its activities**, it is economically significant...(unchanged) >>

**Alternate recommendation no 1**

<< **(c)** it is a public utility or similar entity that provides an essential public service **and has a degree of monopolistic power over its existing customers** or

**(d) irrespective of the nature of its activities**, it is economically significant...(unchanged) >>

**Alternate recommendation no 2**

Eliminate criterion (c) altogether and enhance criterion (d) to read like:

<< **(c) [previously (d)]irrespective of the nature of its activities**, 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, **number of customers served and monopolistic power over its existing customers**>>

**Note :** “monopolistic power with respect to its existing customers” is something different from the general term “market dominance” and it attempts to describe the situation where a small company provides an essential public service in such a business context that its customers cannot easily switch suppliers – and so the “essential service” principle overrides the “insignificance” and small size of the company by usual market standards.

### **ISSUE 3 - Question 3d**

I strongly disagree with the use of the unanimity principle in the matter whether to apply full IFRSs or the SMEs standards. A veto right gives to an individual a disproportionate power over an essentially collective organization such as a company. I understand that perhaps the provision takes into account the fact that a company that does not satisfy the criteria for public accountability is unlikely to have a large number of owners. But how large is "large"?

A company with, say, ten individual shareholders, may be truly out of public accountability, while it aspires to modernize its reporting statements and therefore wishes to move out of its national standards and adopt SMEs standards. Any small (and unrelated to reporting matters) friction among its shareholders may cause it to abandon the project altogether due to the unanimity principle getting in the way.

Consider also the case where national law requires a company to adopt "IASB standards", *leaving the choice between full IFRSs and SMEs standards to the rules of IASB only* (a desirable and perhaps likely scenario in the years to come). Here, a single owner among the many could very well oblige a "true SME" to adopt full IFRSs for whatever reasons of perceived personal interest, creating unnecessary costs for the company and reducing its efficiency.

#### **Recommendation**

Eliminate the requirement. Moreover I should not consider it appropriate for IASB to attempt to impose decision-schemes on the owners of a company. When full IFRSs are adopted, the burden of assurance on their correct and complete employment rests with the existing structure of controls: Management, Board of Directors, Internal and External Auditors... the same structure should be held accountable for the decision on whether a company should apply SMEs standards or full IFRSs

### **ISSUE 5**

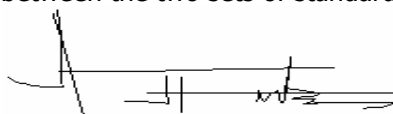
An SME should fully comply with the requirements of the SMEs standards with no optional reversion to an IFRS. Such kind of discretion should not be built into the system.

#### **Recommendation**

If an SME believes that in a particular case the provisions of the SME standards are misleading, while the provisions of the relevant full IFRSs are the appropriate ones, then it should be permitted to disclose the effect of the use of the full IFRSs on its statements as an **alternative treatment** in the notes to the balance sheet.

### **QUESTION 9**

IASB should develop a special standard covering transition from the SME standards to the full IFRSs. This standard would function also as the place where all differences between the two sets of standards are presented together.



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