



*Professor Peter Walton*

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**CL 8**

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Dear Paul

### **Standards for SMEs**

Having been a member of the British CCAB working party on SMEs in the early 1990's and subsequently carried out research for the UN and chaired their working party, I should like to comment on the Preliminary Views of the IASB on this subject. For the sake of completeness, I am responding to the questions posed in the document, and adding further comments, as suggested in the paper, as a final section.

Q1

- (a) I agree
- (b) I agree
- (c) I agree

Q2

I agree, but I think that the IASB should review its position on management use. It seems too easy to say that IASB does not address the needs of management, and move on. Given that, as IASB notes, owner managers are the primary users, this is perhaps the single most important difference between SME financial reporting and that of listed companies. The statement, drawn from the Framework, that management has the ability to determine the form and content of information for their own purposes, is not necessarily true for many small entities. The field work done by the Un and some UK studies suggest that typically the owners do not have either management or financial training, do not know in many cases know what information to ask for and are reluctant to incur costs to seek advice in this area.

Clearly there is no case for the IASB to start specifying management accounting information, but they could bear in mind when specifying external financial reporting rules, that for smaller entities, the annual statements may be the only objective information that owner managers see.

(a) I agree

(b) I agree, but there is considerable distance in information needs and economic resources as between a business with two employees and one with two hundred. It might be helpful to discuss, in the Basis for Conclusions, whether national regulators might want to recognise micro-businesses as a further category and allow them, for example, to use simple accrual accounting, as recommended by the UN.

(c) I agree

(d) While I acknowledge the validity of the Board's concern, insisting upon unanimity is to put a bargaining weapon into the hands of shareholders which in practice be used in the context of other grievances. This sort of safeguard ought only to be necessary if there is a major loss of information to users when an entity adopts SME standards. However, the main rationale for the SME set is that the entities concerned just do not have the complex economic situations envisaged in some IFRS, not that they do not need to reflect their financial situation. A shareholder might find that they had *more relevant* information under SME standards. The directors, controlled by the auditor, need to be sure they are fairly representing the situation, and this may be sufficient safeguard. At least the IASB should defer a decision on this aspect until the SME standards have been drafted, to assess whether there is a danger of information loss.

(e) I agree

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I agree. If the SME standards are a form of cut down IFRS, full IFRS are the logical default, if further detail is required.

5

(a) I believe that entities should adopt either full IFRS or the SME rules. Where the entity has a free choice on individual standards, if this is widely exercised, users would lose any clear concept of what to expect from statements drawn up using SME rules. There would be variable rules, with IFRS and SME rules forming the boundaries. It seems logical that, under question 4, entities should be required to seek detail in full IFRS, but not to have a free choice between the SME set and any other alternative allowed by full IFRS. The concept of the SME set would become very blurred.

(b) I prefer no choice, but if choice is allowed, it is difficult to see how it could be other than standard by standard, to avoid cherry-picking.

6

I agree.

7

(a) I agree, but I believe it would be useful to reflect further on what costs should be considered. I have developed this issue further under question 9.

(b) I agree

(c) I accept the principle that there should not be different definitions of assets and liabilities between the two sets of standards, therefore I think that recognition rules should be the same. However, if the objective is to simplify, some measurement modifications should be contemplated.

8.

(a) I agree.

- (b) If the objective is to simplify, then it seems paradoxical to preserve the random sequence of the existing standards. Retaining the sequence would push those interested into relying on commercially produced guides, rather than using the IASB material directly, because organising by standard, not by topic, makes it difficult for a less qualified person to look for a solution. There is no difficulty in cross-referencing the material too the original standard, which the discussion paper cites, and it seems odd that the IASB and staff think they might accidentally miss something! (If they did, we live in an age of continuous improvement, so is that a problem?)
- (c) I agree, although, if a topical sequence were followed this would require more editorial expertise (but this is well within the staff's capabilities).

9.

I should like to mention a few issues that were discussed in the UN's meetings:

- (a) It is probable that SMEs have fewer and simpler transactions than larger companies, and that, as a consequence, the aim of SME rules should be to pick out from IFRS the most commonly applicable elements. IASB members will be familiar with the 80/20 notion: in this case it might be applied to suggest that 20% of the rules may cover 80% of transactions.
- (b) Because SMEs are by definition small units, their costs per transaction of doing accounting are probably higher than those of a multinational: training costs, software etc. are allocated across fewer transactions.
- (c) Using professionally-qualified accounting firms is probably unnecessarily expensive for smaller entities, because the firms' charge-out rates reflect the high education cost of their professionals. Providing simplified rules for SMEs can help to reduce their accounting costs by allowing entities to employ technical-level staff whose level of technical education is based on the SME standards, and allowing firms to develop SME units using less costly staff, subject to supervision. Insisting that all accounting personnel need to be trained to full IFRS level feeds in to higher costs for SMEs.
- (d) When an investor in a multinational company looks at the financial statements, they are obliged to rely very heavily on the statements for confirmation of the existence and values of the group's assets and liabilities. The financial statements are a crucial confirmation of the financial situation. However, anybody who deals with an SME, whether investor, lender, supplier or employee, can mostly walk round the entity's premises and see the assets. They can talk with management, and they are probably part of a local network where they can talk informally with other people who deal with the entity. It is much simpler to know more about the company, and consequently, while the financial statements remain an essential tool, they are not as central in an evaluation of the entity as with a multinational group.

Yours sincerely

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