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Dear Dr Pacter

Discussion Paper: Preliminary Views on Accounting Standards for Small and Medium-sized Entities

Thank you for providing the opportunity for CPA Australia to comment on the abovementioned Discussion Paper. Our comments have been developed after consultation with members through our Centres of Excellence, most notably our Financial Reporting and Governance Centre of Excellence.

Our overall position is that SMEs (however defined) should apply the same measurement and recognition requirements as entities applying full IFRSs. That is, we do not consider that 'profit' or 'assets' or 'revenue' take a different meaning for different classifications of entities except where, for example, a requirement could not apply to all classifications of entities. The only place where we anticipate different recognition and measurement requirements being appropriate is where some for-profit requirements such as impairment cannot be applied to not-for-profit entities. If the classification of an entity were to drive the recognition of profit and net assets, we would have difficulty in claiming that both provide a fair presentation. Further, guidance providing a migration path between classifications would be required.

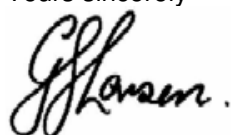
We consider that IASB Standards for SMEs potentially serve three purposes:

- Shorter standards containing simplified requirements are likely to be more user friendly than full IFRSs. Standards for SMEs should be simpler because a number of requirements in full IFRSs are likely to only affect larger entities.
- Reduced presentation and disclosure requirements may be appropriate for SMEs as the cost-benefit relationship for SMEs is likely to be different from those applying to "larger" entities applying full IFRSs because of the generally more simple operations of SMEs.
- Standards for SMEs may provide a practical migration path for lesser developed economies planning to move to full IFRSs. We acknowledge that Standards for SMEs may not properly apply to "larger" entities in lesser developed economies, and such entities could not claim compliance, but we suspect that simpler Standards may provide a viable pathway to applying full IFRSs for such entities.

Our answers to the questions raised in the Discussion Paper are attached. These are to be read without any assumption that we accept the proposed accountability criterion. Our views on that issue are covered in Section 3.

Please contact either Ms Patricia McBride, our Financial Reporting and Governance Policy Adviser on E-mail: Patricia.McBride@cpaaustralia.com.au or myself if we can be of further assistance in this project.

Yours sincerely



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Comments on Discussion Paper

Preliminary Views on Accounting Standards for Small and Medium-sized Entities

1. Whether the IASB should develop Standards for SMEs

The response to this issue must depend on the definition of SME. An SME can be defined in such a way that:

- SMEs are those entities where there are no users interested in the entity's financial report; or
- SMEs are those entities where the burden of applying full IFRSs is so heavy that a simplified set of standards is warranted.

If the first definition of SME is applied, then we see no benefit in developing special reporting standards for SMEs. In Australia, similar entities are termed "non-reporting entities" and already have a reduced reporting burden under accounting standards on the grounds that their reporting is for compliance purposes rather than to provide financial information. (In other jurisdictions, reporting based on taxation requirements may be considered appropriate for such entities.) It seems unnecessary to impose additional reporting burdens on such entities when there are no interested users of the financial statements.

If the second definition of SME is applied, then we consider that the work involved in developing special financial reporting standards for SMEs is warranted. Smaller entities are often simpler entities and do not need to understand or apply the more complicated parts of IFRSs that address the activities of larger more complex entities. The difficulty in taking this approach is to distinguish SMEs from entities that ought to apply full IFRSs.

The other benefit we see in the Board developing special financial reporting standards would be to provide developing economies with a simpler entry level into IFRSs. We consider it preferable for the Board rather than individual jurisdictions to determine the content of "IFRSs-lite" standards, thus providing consistency between entities across jurisdictions.

1a Do you consider that full IFRSs should be considered suitable for all entities?

We consider that full IFRSs should be considered suitable for all entities. Comparability can only be achieved if all entities are able to apply the same set of Standards.

1b Do you agree that the Board should develop a separate set of financial reporting standards suitable for SMEs?

We support the development of a separate set of financial reporting standards suitable for SMEs, as long as they do not conflict with our primary principle that all entities should measure assets, liabilities, revenues and expenses in the same way. Given that many SMEs do not have the complicated operations of larger entities, we support the development of standards that address the recognition and measurement of their most likely operations, as long as each SME standard identifies where the full IFRSs contains material omitted from the SME standard.

We have some concerns that developing a separate set of reporting standards suitable for SMEs may weaken the IASB "brand". However, on balance, we consider that the benefits of such development outweigh the potential costs as long as the basis of such standards is carefully communicated to the market.

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?

We consider that the Board should determine the types of entities that are able to apply IASB Standards for SMEs and that entities that should apply full IFRSs cannot be described as being in compliance with IFRSs for SMEs, even if application of IFRSs for SMEs is permitted by local regulations. Where an entity applies IASB Standards for SMEs and is not eligible to do so, we would encourage disclosure of the basis of preparation of the financial statements.

2. Objectives of IASB Standards for SMEs

Preliminary view 2 proposes that IASB Standards for SMEs should:

- Provide high quality, understandable and enforceable accounting standards suitable for SMEs globally
- Focus on meeting the needs of users of SME financial statements
- Be based on the same conceptual framework as IFRSs
- Reduce the financial reporting burden on SMEs that want to use global standards
- Allow easy transition to full IFRSs for those SMEs that become public 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?

Subject to our concerns with the definition of public accountability discussed in issue 3, we support the objectives of IASB Standards for SMEs set out in preliminary view 2.

3. Definition of SME

We note that the Board assumes in the following questions that 'public accountability' is an appropriate criterion for identifying an SME without directly asking that question. In our view, the definition of public accountability needs to be reviewed to ensure that due consideration is given to the needs of users of financial statements identified in the *Framework for the Preparation and Presentation of Financial Statements*.

The *Framework* identifies a number of categories of users of financial statements (including employers, customers and suppliers) whose existence is not recognised specifically in the definition of public accountability. We consider that the notion of public accountability needs to be broadened to consider users other than those that are identified in paragraph 31 of Preliminary View 3.3. We consider that these other users of financial statements have as much right to be serviced as do investors, potential investors, entities service in a fiduciary capacity and users of public utilities. The Australian definition of 'reporting entity' takes a broader approach to the identification of an entity where users would reasonably expect the preparation of full 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'?

We support the Board applying a principles-based approach and describing the characteristics of the entities for which it develops any standards for SMEs. We do not consider that size reflects a principles-based approach or is a notion that can readily be defined to apply consistently across jurisdictions.

However, if the Board were to prescribe a size test, the size test should be combined with an appropriate qualitative test to ensure that small entities with a significant number of users who require full financial statements, such as small listed entities, are required to prepare full financial statements.

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?

We support the development of two levels of standards: standards for entities that should apply full IFRS and standards for entities that should apply IFRSs for SMEs. We consider that each jurisdiction should determine which entities (if any) should apply which form of the standards with the proviso that any application that is not in accordance with the decisions of the Board could not be claimed to be in accordance with IFRSs.

We suspect that many jurisdictions do not require very small entities to prepare financial reports separate from their reports for regulatory authorities such as taxation

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’?

Please note our comments in the introduction to this section. We consider that the definition and presumptive indicators for identifying an SME should be broadened to include users of financial statements other than investors.

3d Do you agree that an entity should be required to issue 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?

We have a number of concerns with this proposal.

First, it is unclear whether ‘owner’ is intended to include all holders of equity instruments or is limited to holders of some form of ‘plain vanilla’ shares. We recommend that owners for this purpose be limited to owners of ‘plain vanilla’ shares.

Second, we would be concerned if an owner of a single share were able to mandate the preparation of full IFRSs financial statements against the wishes of all the other owners. Under Australian legislation, preparation of the financial statements is the responsibility of directors and not the responsibility of owners. However, where an entity is not required under general legislation to prepare financial statements, the preparation of financial statements is still required where shareholders with at least 5% of the votes require such preparation. We recommend that the threshold for mandating full IFRSs be lifted above that of a single owner.

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?

We consider that a subsidiary, joint venture or associate of an entity preparing financial information in accordance with full IFRSs should prepare its own financial information in accordance with full IFRSs. However, we do not consider that such entities should be required to present their financial statements in accordance with full IFRSs, but rather should be permitted to provide reduced disclosures in accordance with IASB standards for SMEs if they meet the definition of an SME.

As stated above, we consider that all entities preparing financial information should apply the same measurement and recognition requirements. We have trouble in accepting that the measurement of a transaction can depend on the size or importance of an entity. We hold this view because we consider that concepts such as ‘profit’ and ‘asset’ are not size dependent but accept that for SMEs the cost of making extensive disclosures may outweigh the benefit.

4. Mandatory fallback

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?

We agree that 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. In keeping with our view that profit and assets should be measured and recognised on the same basis regardless of the classification of the entity, we consider that a fallback to the appropriate IFRS is the only option.

5. Optional reversion to an IFRS by an entity using IASB Standards for SMEs

5a Should an SME be permitted to revert to an IFRS if the treatment in the SME version 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?

We consider that the recognition and measurement requirements in full IFRS should always be the same as that in the SME version. For more complicated requirements, the SME standard should make reference to the full IFRS. We would also accept complicated disclosure requirements being excluded from the SME version under cost-benefit considerations. We therefore consider that reversion should be available at any time.

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)?**

As we consider that reversion to an IFRS is only necessary if a SME has a recognition or measurement issue that has been omitted from the SME version, or wishes to make additional disclosures, we support the principle-by-principle approach. In our view, the difference between the standard-by-standard approach and the principle-by-principle approach should be whether an SME electing to make some additional disclosures is required to meet all the disclosure requirements in the full IFRS.

6. Starting point for developing IASB Standards for SMEs

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?

We 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. In our view, the modification should be limited to:

- Removing recognition and measurement requirements and guidance that are considered unlikely to apply to SMEs, while noting where full IFRSs contains additional requirements or guidance that is unlikely to be relevant to SMEs
- Simplifying the presentation prevention or disclosure requirements to reduce the burden on preparers.

7. Appropriate bases for modifying concepts and principles for SMEs

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?

The modifications that we envisage (as identified above) should be based on the identified needs of users of SME financial statements or cost-benefit analyses.

7b Do you agree that it is likely that disclosure and presentation modification will be justified on the basis of user needs and cost-benefit analysis and that the disclosure modifications could increase or decrease the current level of disclosure for SMEs

We would like to think that user needs would drive any disclosure and presentation modifications but we doubt that it is possible to identify user needs, given the wide range of entities that might be classified as SMEs. Therefore, we anticipate the disclosure and presentation modifications will be justified on the basis of estimated cost-benefit analyses.

Whether any disclosure modifications increase or decrease the current level of disclosure for SMEs will depend on the present disclosure requirements placed on those entities and the disclosure requirements included in IASB Standards for SMEs. Australian entities classifying themselves as 'non-reporting' presently have reduced disclosure requirements but we are unable to assess at this time the effect of any IASB Standards for SMEs.

8. Format for publishing IASB Standards for SMEs

In answering the following questions, we have considered the user-friendliness of the format, how SMEs could best take advantage of training courses and books developed for full IFRSs, and how SMEs might easily graduate to full IFRSs.

8a Do you agree that IASB Standards for SMEs should be published in a separate printed volume?

We agree that IASB Standards for SMEs should be published in a separate printed volume as we anticipate that this will be the most useful format for SMEs.

8b Do you agree that IASB Standards for SMEs should be organised by IAS/IFRS number rather than in topical sequence?

Yes. We consider that this will best position an SME to transition to IFRSs or to apply a specific IFRS in lieu of a specific Standard for SMEs.

8c Do you agree that each IASB Standard for SMEs should include a statement of its objectives, a summary and a glossary of key terms?

We consider that IASB Standards for SMEs should be as user-friendly as possible, and encourage the inclusion of objectives, summaries, glossaries, examples and any other content that will assist this aim. For example, it may be useful to explain the relationship between a specific Interpretation and a Standard.

Other Issues

We reiterate our view that the development of any standards for SMEs should not compromise any recognition and measurement requirements. In our view, the whole benefit of international convergence will be negated if different entities apply different concepts of profits, assets, liabilities, equity, revenues and expenses. If the Board is to permit differential recognition and measurement requirements, it will also need to explain how IFRS 1 *First-time Adoption of IFRSs* is to be applied by entities transitioning from SME status.