

*Your ref:*

*Our ref:*

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Mr R Padarath – (07) 3405 1115

24 September 2004

**CL 50**

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

Dear Sir

## **ACCOUNTING STANDARDS FOR SMALL AND MEDIUM-SIZED ENTITIES**

Members of the Australasian Council of Auditors-General (ACAG) have been canvassed and, subject to the comments contained in the attachment, the following are supportive of the proposals contained in the discussion paper on accounting standards for small and medium sized entities.

- Commonwealth Auditor-General
- Auditor-General of Tasmania
- Auditor-General for Western Australia
- Auditor-General of Queensland
- Auditor-General of New South Wales

The non-inclusion of an ACAG member in the submission does not necessarily mean they disagree with the submission.

Most of the respondents agree that the Board should develop a separate set of financial reporting standards suitable for small and medium-sized entities, and that the Board should describe the characteristics of the entities for which it intends the standards based on quantitative 'size tests', as opposed to a 'public accountability' test. Arguments to support the above positions are contained in the attachment.

The opportunity to provide comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

L J SCANLAN  
Auditor-General of Queensland

## **Appendix 1**

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

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

We disagree that full IFRSs should be considered suitable for all entities, and support the development of a separate set of IFRSs for SMEs for the following reasons –

- to reduce the costs for SMEs in complying with full IFRS which may not be applicable to SMEs and to make the financial reporting process more efficient for these entities;
- to acknowledge that there are differences in the information needs of SMEs and large public entities;
- the detailed reporting required of the full IFRSs may not be necessary for the SMEs; and
- it may not be economically realistic for SMEs to have the financial accounting expertise required for the full IFRSs, in particular, if superfluous information were generated.

The Auditors-General of Tasmania, for Western Australia and the Commonwealth Auditor-General while agreeing that full IFRS should be considered suitable for all entities, also support the establishment of a separate set of standards for SMEs that includes the principles of the full IFRSs.

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

Based on the response provided to Question 1a, we agree that the Board should develop a separate set of financial reporting standards suitable for SMEs. Many SMEs probably find full IFRSs (or equivalents) onerous in terms of cost, expertise and complexity.

The IASB should be the body to develop these standards for consistency with full IFRSs. SME and full standards that diverge on fundamentals will weaken communication between reporting entities and users and harm the credibility of financial reporting and financial reporting professionals.

#### **Question 1c(1). 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?**

We agree with the proposal.

The Commonwealth Auditor-General however, disagrees that SMEs should not be applied to publicly listed entities.

#### **Question 1c(2). 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 with the proposal.

### **Issue 2. What should be the objectives of a set of financial reporting standards for SMEs?**

**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?**

We agree that the objectives of IASB Standards for SMEs as set out in preliminary view 2 are appropriate.

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

**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?**

We agree that the Board should describe the characteristics of the entities for which it intends the Standards to apply to. Overall, Auditors-General believe that those characteristics should prescribe quantitative ‘size tests’ as opposed to public accountability, for the following reasons -

- this would be a more objective test as opposed to the ‘public accountability’ test. In terms of the public sector Auditors-General still have the discretion to report matters to the Parliament in discharging their respective audit mandates. In addition, the Standards will need to acknowledge that in the Australian context the Corporations Act still applies in determining whether small proprietary companies are exempt from preparing financial statements, and therefore, the need to comply with SME Standards.
- the discussion is about standards for SMEs, not publicly accountable enterprises. All entities that interact with the public have some degree of public accountability and the common meaning of the term should not be overridden in this way. The size criterion would make IASB SME standards directly applicable to non-business public sector enterprises. Cost, complexity and expertise concerns arise for these entities as much as for similar-sized entities in the private sector. The IASB will appreciate that the Public Sector Committee of IFAC and Australian Accounting Standards Board each base, or will base, their non-business public sector reporting standards on IFRSs. It will also appreciate that the credibility of Government financial reporting is enhanced and safeguarded where the standards by which Governments and their entities report are made independently by recognised experts. While the Board’s preliminary view is that a size test is not warranted, the leg of the proposed ‘public accountability’ criterion dealing with ‘economic significance’ requires a size test of its own.
- this is what test (d) in preliminary view 3.3 says. Preliminary view 3.2 and 3.3 refers to an entity that provides “an essential public service” as a presumptive indicator of accountability. We suggest that this terminology be explained in the exposure draft. In SAC 1, accountability arises by virtue of the separation between owners of resources and those that manage resources on their behalf. In the Public Sector, “owners” are the general public and Parliament as their representatives, while government agencies are those that manage the resources. Accountability in the discussion paper arises when an entity provides “an essential public service”. This is a significantly different concept to SAC 1. Under the SAC 1 approach, an entity may not be providing an “essential public service” (depending on how this concept is defined) but still be a reporting entity. Also it is not clear whether paragraph (d) of Preliminary view 3.3 is an alternative to paragraphs (a), (b) and (c) or just paragraph (c).

Another issue that should be addressed in the exposure draft is when an entity decides to make financial information publicly available does that give it public accountability status.

**Question 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?**

Based on response to Question 1a, we disagree that full IFRSs should be considered suitable for all entities and support the development of a separate set of IFRSs for SMEs that do not have public accountability and we support the development of a size test, along with other relevant criteria, as opposed to a public accountability test, although the size test may differ between jurisdictions.

**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?**

Based on the response to Question 3b, we believe the size test along with other relevant criteria is more appropriate as opposed to a public accountability test, therefore, we have not commented on whether the two principles in preliminary view 3.2 and 3.3 provide a workable definition and appropriate guidance for applying the concept of ‘public accountability’.

**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?**

We disagree with the proposal on the basis that the entities meeting the size criterion for SMEs should always apply SME standards, else those standards may become devalued to users, preparers and standard setters, and this is an internal issue for the entity to resolve.

However, the Auditors-General for Western Australia and of Tasmania agree with the proposal given that the non-owner managers of an SME may require the use of the full IFRSs because of the financial links they may have with the entity.

Although an overall size test may alleviate this problem, the application of the Standards for SMEs may have to be assessed on a case-by-case basis with consideration given to materiality and the nature of the entity e.g. accountability and transparency requirements for public sector entities.

**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 with the proposal that if a subsidiary, joint venture or associate of an entity that is an SME 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. All SMEs should be required to report against SME standards, for the reasons given in Question 3d. Further, users may find the SME’s full IFRS statements too complex and one of the benefits of having SME standards will be lost.

**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?**

**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 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. This mandatory fallback to the respective full IFRS, when the IASB standards for SMEs do not address a particular accounting issue, is acceptable as it provides a consistent approach and enables inter-entity comparability of SMEs financial statements.

**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?**

**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 believe that an SME should be required to adopt the complete set of SME standards with no optional reversion to individual IFRSs as the optional reversion to full IFRS would impair comparability between SMEs and, perhaps more importantly, risk relegating SME standards to a secondary status

**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?**

We believe that if an SME is permitted to revert to an IFRS, it should be on a standard-by-standard approach. The other options may generate unnecessary scope for debate between auditors and preparers over where the boundaries may lie, and will confuse users. In addition a standard-by-standard approach will promote consistency in its application, as the other two options require judgement which may be subjective and debatable.

**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?**

**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 with the proposal that the 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. Economies can be gained by basing the SMEs Standards on full IFRSs because of the applicability of the IFRS concepts and principles to SMEs.

**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?**

**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 support the view that any modifications for SMEs to the concepts or principles in full IFRS must be on the basis of the identified needs of users of the statements 'and' cost-benefit analyses. We also suggest that the guidance in SAC 3 *Qualitative Characteristics of Financial Information* paragraphs 42-45 could be of assistance.

**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 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.

**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 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.

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

**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 IASB Standards for SMEs should be published in a separate volume because of the ease of use by the SMEs. The SMEs standards need to be written in a simpler language and the differences with the full IFRSs highlighted.

**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.**

We agree that the IASB Standards for SMEs should be organised by IAS / IFRS number rather than in topical sequence. It would be useful to have an index of topics cross referenced to the relevant full IFRSs and SMEs Standards.

**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 agree that each IASB SMEs Standard should include its own statement of objective, summary and a glossary of terms for ease of reference.

**Question 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 have not identified any other matters related to how the Board should approach its project to develop standards for SMEs.