

**CIPFA RESPONSE TO IASB
DISCUSSION PAPER:
PRELIMINARY VIEWS ON
ACCOUNTING STANDARDS
FOR SMALL AND MEDIUM
SIZED ENTITIES**

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AT THE HEART OF
PUBLIC SERVICES 

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CIPFA RESPONSE TO IASB DISCUSSION PAPER, *PRELIMINARY VIEWS ON ACCOUNTING STANDARDS FOR SMALL AND MEDIUM SIZED ENTITIES*

1 INTRODUCTION

CIPFA welcomes the opportunity to respond to the International Accounting Standard Board's Discussion Paper, *Preliminary Views on Accounting Standards for Small and Medium Sized Entities*. CIPFA's response has been produced by its Accounting and Auditing Standards Panel.

2 GENERAL COMMENTS

CIPFA supports the development of a set of international standards for small and medium sized entities (SME). In the UK, an accounting standard for small entities (FRSSE) has been in place for a number of years and has been widely supported by both preparers and users of financial statements. However, CIPFA has serious concerns about the approach adopted in the discussion paper. In particular:

- the use of a public accountability test rather than one based on size or a combination of criteria for the use of SME standards
- the intention to have a corresponding SME standard for each IFRS, including IFRIC interpretations where relevant and to change these every time the full IFRS changes
- the proposed mandatory fallback to full IFRS for any particular issue not addressed in the SME standard
- the option to choose either full IFRS or SME standards within the same set of accounts which seems likely to have adverse effects on both reliability and comparability.

We elaborate on these issues below when answering the specific questions set out in the discussion paper. CIPFA's general view, however, is that for most countries – and for developing nations in particular – the proposed standards are too onerous for small entities which have so far not been following IFRS or anything comparable to them. If SME standards are to apply to all non-publicly-accountable entities, they need to be much simpler; alternatively, they need to allow total exemption, at least on a temporary basis, for entities below a certain size and complexity.

3 ISSUES ON WHICH COMMENTS WERE INVITED

Question 1a

Do you agree that full IFRS should be considered suitable for all entities?

No. IFRSs have been designed primarily for entities of considerable size with access to the capital markets and are not necessarily suitable for others.

Question 1b

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

Yes, but these need not mirror exactly full IFRSs on a standard-by-standard basis. It would be preferable to group them by topic having regard to the less sophisticated nature of the entities to which they are intended to apply.

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 would permit this? Do you also agree that if the IASB standards are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs?

Yes. We agree that SME standards should not be used by publicly listed entities. Where IASB standards for SMEs are used by publicly listed entities we agree that they are not in compliance with IFRS 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 are appropriate. However we have serious doubts as to whether they will in fact be achieved if the remainder of the proposals in the discussion paper are implemented as they stand.

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'?

No. We consider that size tests should be used, in conjunction with qualitative criteria. More restrictive size tests could then be determined by national governments, some of which already prescribe size tests in respect of national accounting standards. It is appropriate that the size tests should take into account in each country the relative sophistication of the business sector and the availability of accounting expertise.

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 on the relatively larger ones or only the relatively smaller ones?

We do not consider that the distinction solely on grounds of public accountability is

sufficient when developing standards. The range of entities which are not publicly accountable as defined by the Board is too wide to accommodate a single set of modified international financial reporting standards. At the very least, distinctions need to be drawn between entities operating on a national or even multinational scale, but privately owned, and very small entities providing basic goods and services locally. The Board's proposals seem better suited to organisations at the larger end of the range and these arguably have less need of SME versions of IFRSs than smaller, less sophisticated entities.

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?

Yes, although we note that 3.3(d) envisages a size test for economic significance which appears to contradict preliminary view 3.1.

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 objects to the entity's preparing its financial statements on the basis of IASB standards for SMEs.

No. We consider it inequitable that one (possibly very small) stakeholder out of many should be able to require the entity to use full IFRSs. We consider that it should be sufficient to rely on the indicators of public accountability set out in preliminary view 3.3(a-d). If none of those conditions are satisfied, there should be a presumption against public accountability unless the owners as a whole, or at least a majority of them, think otherwise.

Question 3e

Do you agree that if a subsidiary joint venture or an associate of an entity with public accountability prepares financial information in accordance with full IFRS to meet the requirements of its parent, venturer or investor, the entity should comply with full IFRS and not IASB standards for SMEs in its separate financial statements?

No. The financial information published by an individual entity should be determined primarily by the circumstances of that entity (subject to certain safeguards) and not by that of its parent or investor. Users of financial information can look to the financial statements of the parent or the investor for more detailed information.

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?

No. This is an onerous requirement for smaller entities. We would prefer a

modification such that relevant IFRSs should be referred to as a means of establishing generally accepted accounting practice but without a mandatory requirement for SMEs to follow them in every detail, including any relevant IFRICs.

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 IFRS?

We believe strongly that an SME should use either the SME versions in the IFRS in their entirety or not at all. If a 'pick and mix' approach is permitted it will impair comparability between entities and within an individual entity over time, unless changes after the initial introduction of SME standards are not permitted. There is likely to be a perception (which may or may not be justified in a particular case) that an entity choosing a mixture of full IFRS and SME standards is doing so solely to enhance its results or financial position. There would also be a practical difficulty for auditors in expressing an opinion in such circumstances.

Question 5b

If an entity is permitted to revert to an IFRS, should it be:

- a) required to revert to the IFRS in its entirety*
- 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; 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?*

As stated above, we do not believe that an entity following SME standards should be permitted to revert to an IFRS on a particular issue. All the three options suggested (standard-by-standard, principle-by principle, and a mixture of the two) will detract from the credibility of SME standards and cause confusion in the mind of the reader.

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 of the related mandatory guidance from IFRSs (including interpretations) and then making modifications deemed appropriate?

We agree that fundamental concepts of the Framework and the principles informing IFRSs should normally be applied when developing SME standards. We are less convinced that interpretations should be accorded the same importance and we consider that the needs of users and the costs to preparers should be fundamental considerations when developing standards for SMEs.

Question 7a

Do you agree that any modifications for SMEs to the concepts or principles in full IFRSs must be of the basis on the identified needs of users of SME financial statements or cost benefit analyses?

If so, do you have suggestions about how the Board might analyse the costs and benefits of IFRSs in an SME context?

We agree. Benefits are virtually impossible to quantify, except by default: for example, the effects on stakeholders and society generally of failures of financial reporting. Costs of compliance can be quantified, at least approximately, but only if the entities affected are categorised by size and/or type. The population of non-publicly accountable entities is simply too diverse for any meaningful estimates to be made without some such analysis.

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 by SMEs?

We agree that disclosure and presentation modifications are likely to be justified on these bases. We find it hard to find justification for increasing the level of disclosure and consider that this would normally be undesirable in any event as it could lead SMEs to choose to avoid adopting the standards produced for their benefit.

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?

We do not think there should be a presumption either way, although if the fundamental principles behind IFRSs are to be followed (as stated in issue 6) it is unlikely that major modifications would be justified on grounds other than cost benefit or user needs. We note, however, that the recent survey carried out by IASB amongst 30 national standard-setters showed a majority of respondents in favour of making modifications to recognition and measurement principles as well as to disclosures and presentations.

Question 8a

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

Yes, but our preference would be for there to be one SME standard which would stand alone, although cross-referenced to IFRSs as appropriate. Compliance will be easier for preparers if the requirements are consolidated into one volume.

Question 8b

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

If our preference for one standard is not accepted, we would favour organisation by topical sequence rather than IAS/IFRS number, as this should be far easier for less sophisticated preparers to cope with.

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 consider a statement of its objective to be particularly useful. A summary should not be necessary if the statement itself is succinctly written. A glossary of key terms would be useful.

Question 9

Are there any other matters related to how the Board should approach its project to develop the standards for SMEs that you would like to bring to the Board's attention?

We have a major concern that if the project proceeds along the lines outlined by the Board in its preliminary discussion paper, the result will be extremely onerous for a large number of SMEs in many countries, especially but not only those in the developing world. Many of these at present follow either no prescriptive accounting standards or only very basic ones, perhaps laid down in legislation. For these entities the proposed SME standards will be nearly as difficult to comply with as full IFRSs. Either a third tier of reporting standards will be needed – with major resource implications for the Board - or else a significant number of exemptions, which we consider undesirable in principle and would undermine the Board's efforts to raise the standard of financial reporting amongst all non-publicly accountable entities.