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Mr Paul Proctor
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Dear Mr Proctor

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

I am writing on behalf of the CIOT in response to the Discussion Paper issued in June.

In our view, the preparation of accounts is not an abstract theoretical exercise: accounts should be appropriate for the purpose for which they are required. It seems to us that this Discussion Paper has rather lost sight of the fact that the vast majority of SMEs will always be SMEs, will not have international business and will access capital through their proprietor(s) or local bank.

We are particularly concerned about the content of paragraph 19 of the paper. It begins by stating that the tax authorities are important external users of accounts, but ends by saying that IASB Standards are not intended to meet the needs of tax authorities. The implication is that SMEs may have to produce two sets of accounts, one complying with IASB Standards and the other complying with the requirements of the tax authorities, or make adjustments to get from IASB Standards-based profits to taxable profits. This is most regrettable and, in our view, represents a serious shortcoming in the design of accounting standards.

The Discussion Paper raises the issue of whether the IASB should develop special financial reporting standards for SMEs (Issue 1). It is noteworthy that, in recent years, accounting standards have moved further and further away from historical cost accounting and towards an annual valuation exercise. No doubt this is driven by the needs of investment analysts and fund managers in relation to listed entities. However, we believe that it is inappropriate for SMEs and other unlisted entities. For such entities, the proprietor(s) and the tax authority are the main users of the accounts. Their requirements are a measurement of the historical profit or loss of the accounting period (Issue 2 – see especially para 16(b)) and a simple summary of the position the business is in (by way of a balance sheet).

We would be particularly concerned if the application of the “true reflection” principle, as understood by the Revenue, were to result in revaluation gains and losses taken to reserves under IAS being recognised for tax purposes. This seems wholly inappropriate for SMEs. Indeed, it would open up a further discrepancy between incorporated SMEs and sole traders.

We accept that the adoption of special standards for SMEs would mean that, when a company seeks a listing, it will need to restate its recent accounts on a full IAS basis, but we do not see that as a major problem. Any adjustments can be made as part of the exercise of preparing a Prospectus.

As regards the definition of SMEs for the purposes of FRSSE (Issue 3), we believe that all unlisted enterprises, both incorporated and unincorporated, should fall within the definition, subject to specified exclusions for entities with a public accountability requirement.

We would be happy to meet the IASB to discuss these matters if that would help.

Yours sincerely

Francesca Lagerberg
Chairman, Small Business Working Group