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## **Discussion Paper**

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

FAR, the institute for the accountancy profession in Sweden, is responding to your invitation to comment on the Discussion Paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities*.

#### **Introduction**

The Discussion Paper brings up the fundamental question if the IASB should develop special financial reporting standards for SMEs. The great majority of all entities in the world are small or medium-sized entities, no matter how small or medium-sized is defined. These entities often find it difficult or very costly to apply full IFRSs. Additionally some of the IFRS information might not be relevant for or used by the users of financial statements of smaller entities.

#### **General comment**

In light of the present objectives of both the IASC Foundation and the IASB, FAR finds it doubtful if IASB really should be the standard setter for the SMEs. These objectives clarify the focus of the efforts to be to develop global accounting standards for use in the capital markets. For a significant portion of the SMEs this has limited relevance. Therefore, FAR finds it doubtful if IASB should use its resources to be the standard setter to develop standards for SMEs.

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

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

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

*Question 1 c. - 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*

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*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?*

### **Response**

Response 1 a. – No, full IFRSs should not be considered suitable for all entities. The quantity of information required by full IFRSs can not be justified for SMEs, both due to user needs, (the group of parties with a direct interest in a SME is limited), and due to cost-benefit considerations.

Response 1 b. – No, we disagree. See General comment above regarding the objectives of IASB. If the objectives are altered to cover also SMEs, FAR believes that the resources and funding of IASB also must be discussed.

Response 1 c. – In our view the global standard setter for SMEs (could be the Board if certain changes are decided such as those mentioned under response 1b) is to produce a set of IFRS for SMEs that it believes will be a suitable basis for general purpose financial reporting by a range of entities, whose needs are not being well met by full IFRS. In doing so, the standard setter should specify the characteristics of the entities that it has in mind as users of IFRS for SMEs, consideration of which have shaped their development. However, the standard setter having done that, and delivered a product, it then falls to local governments and regulators to prescribe where IFRS for SMEs shall, or may, be used, according to the needs of the particular local environment.

On the basis that financial statements prepared in accordance with IFRS for SMEs will state that fact, and that auditors will refer to it as well, it would seem to be transparent which standards have been used. Although we would not expect the regulatory authorities of publicly listed companies to permit the use of IFRS for SMEs, we do not see it as the standards setter's job to make that decision for them. We observe that the Board is not suggesting to place a similar restriction on the use of full IFRS by very small entities for which full IFRS may not be appropriate.

### **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?*

### **Response**

The objectives of IASB Standards for SMEs in preliminary view 2 (a)-(d) are deemed appropriate. However objective (e) “to allow easy transition to full IFRSs for those SMEs that become publicly accountable or choose to switch to full IFRS” is in our opinion secondary to objective (a)-(d). If the SME standards are developed based on objective (e) we believe there is a risk for that the standards become too far-reaching and that the objectives (b) and (d) are weakened.

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

*Question 3 a. - 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?*

*Question 3 b. - 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?*

*Question 3 c. - 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?*

*Question 3 d. - 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?*

*Question 3 e. - 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?*

**Response**

Response 3 a. – We are of the opinion that the standard setter (could be the Board as described above) should describe the characteristics and prescribe a quantitative size-test for the entities for which it intends the standards. National regulators can prescribe additional size criteria if they wish, appropriate to their environment and intention. The characteristics and the size-test will together give clear rules for what entities SME standards are applicable. We think that the size-test should be based on three parameters; number of employees, total assets and net sales.

Response 3 b. – We think that the standard setter (could be the Board as described above) should develop standards that would be suitable for all entities except the very small ones, i.e. the entities that do not meet the size-test described in 3 a. above. The standards for the smallest entities can with advantage be developed by local authorities or regulatory organizations with a fiscal co-operation in order to develop standards that facilitate financial and fiscal reporting.

Response 3 c. – 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' for group accounts, but not for separate financial statements for individual entities. Several countries do not allow full IFRS for separate financial statements.

Response 3 d. – No. The objection from only one owner is not reasonable, not from a user need perspective nor from a cost-benefit perspective. We consider that this is a matter either for local governments or for the internal arrangements for the entity involved.

Response 3 e. - No. It is the consolidated group that is public accountable. Relevant information is given in the group accounts. Full IFRSs should be used for the subsidiary, the joint venture or the associate only if the separate entity itself meets the criteria for public accountability.

**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?*

**Response**

Yes, we agree.

**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 5 a. - 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 version to individual IFRSs? Why?*

*Question 5 b. - 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 favor c., what criteria do you propose for defining 'related' principles?*

**Response**

Response 5 a. – No, reversion to an IFRS should not be allowed, but it should be required to apply the complete set of SME standards or to apply the complete set of IFRSs. The use of only one set of rules and regulations makes the understanding and comparability of the financial statements easier for the user.

Response 5 b. – Reversion should not be allowed, see 5 a. above. However if reversion would be allowed, we think that (a) a standard-by-standard approach would be the best choice.

**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?*

**Response**

Yes, we agree. FAR is of opinion that the fundamental concepts for recognition and measurement should be the same for all entities.

**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 7 a. - 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?*

*Question 7 b. - 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?*

*Question 7 c. - 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?*

**Response**

Response 7 a. – Yes, we agree. We suggest that the standard setter, (could be the Board as above) when it comes to a cost/benefit analysis of IFRS for SMEs, should consult with

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standard setters, preparers and users that have experience from; a) handling 2 sets of financial reporting standards, and/or b) the transfer from one set of financial reporting standards to an other set of financial reporting standards.

Response 7 b. – Yes, we agree.

Response 7 c. – Yes, we agree.

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

*Question 8 a. - Do you agree that IASB Standards for SME should be published in a separate printed volume? If you favor including them in separate sections of each IFRS (including Interpretations) or some other approach, please explain why.*

*Question 8 b. - Do you agree that IASB Standards for SMEs should be organized by IAS/IFRS number rather than in topical sequence? If you favor topical sequence or some other approach, please explain why.*

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

**Response**

Response 8 a. – Yes, we agree.

Response 8 b. - We think that IASB Standards for SME should be organized by topical sequence as this would be more user friendly for this category of entities.

Response 8 c. – No. We believe that is preferable to have this kind of information gathered in sections in the beginning of the “SME book”.

**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?**

**Response**

It is important to find a title that expresses the types of entities for which these standards are intended better than "SMEs", which means different things in different jurisdictions, and almost certainly involves size criteria.

Yours faithfully,

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Jan Buisman

Chairman, Accounting Practices Committee

Dan Brännström

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