



## International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA  
Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 [www.ifac.org](http://www.ifac.org)

September 22, 2004

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

By Email: [CommentLetters@iasb.org](mailto:CommentLetters@iasb.org)

Dear Paul,

**Discussion Paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* – Published for comment by the International Accounting Standards Board**

THE INTERNATIONAL FEDERATION OF ACCOUNTANTS

1. The International Federation of Accountants ('IFAC') fully supports the International Accounting Standards Board ('the IASB') in its quest to develop high quality global accounting standards and to further international convergence of such standards. IFAC, therefore, welcomes the IASB's initiative to develop financial reporting standards for small- and medium- sized entities ('IASB Standards for SMEs').
2. This submission is organized into four parts. First, the reasons are documented as to why IFAC considers the development of special accounting standards for small- and medium- sized entities ('SMEs') a high priority. Second, the basis for this submission is explained. Third, general background issues are presented, including the principles underlying the specific responses. Finally, responses to specific issues and questions are set out in a broadly sequential order.

ACCOUNTING STANDARDS FOR SMALL AND MEDIUM-SIZED ENTITIES

3. IFAC considers the IASB's proposal to develop IASB Standards for SMEs to be both timely and deserving of high priority for the following reasons:
  - SMEs play a key role in all of the world's economies and, by implication, that of the global economy. It follows, therefore, that the IASB's Standards for SMEs have the potential to make a significant contribution towards furthering the public interest and nurturing global economic development.

- As an international accounting standard setter with global convergence as an objective, the IASB has a responsibility to consider and accommodate the needs of all types of entity (whether small, medium or large). There is a common and growing perception that the IASB is failing to take sufficient account of SMEs, which is of particular importance for international acceptance of and convergence to IFRS. This initiative, conditional on its outcome, will go some considerable way towards dispelling this perception.
- Although the IASB has not indicated that full International Financial Reporting Standards ('full IFRSs') are designed or intended only or primarily for entities whose securities are listed on public capital markets it is clear that they have, for whatever reason, come to be more suited to the users of the financial statements of such entities than those of SMEs.
- The benefits from using financial statements prepared on the basis of full IFRSs are difficult to quantify. Nevertheless, it is IFAC's view that for SMEs as a group these benefits will be exceeded by the costs of compliance, costs which only stand to escalate in the future as full IFRSs increase in their complexity and scope.
- Concerns over the high costs of complying with full IFRSs has prompted many countries, especially those with smaller developing economies, to demand a much less onerous set of accounting standards.
- In some instances the demand for special accounting standards for SMEs is being filled by organizations that have not been traditionally involved in standard setting and that may be inappropriate for such a role. The IASB, by virtue of its resources and credibility amongst the wider business community, is the most appropriate body to develop and issue special accounting standards for SMEs.

#### BASIS FOR THIS SUBMISSION

4. In preparing this submission special regard has been paid to those constituents within IFAC with first hand experience of the accounting and audit of SMEs, for instance the Small and Medium Practices Permanent Task Force and the Developing Nations Permanent Task Force.
5. Given the diversity of IFAC's membership, and that of its member bodies, compiling a single IFAC response that is wholly satisfactory to all of its constituents has proved impractical. Not surprisingly, the views expressed by IFAC's constituents varied, sometimes substantially, and often reflected a particular national stance. Therefore, when formulating the views expressed herein IFAC has sought to take a global, public interest perspective, which may not always be consistent with individual national laws, regulations and interests. IFAC recognizes also that those IFAC member bodies with diverging views have the opportunity to make these views known to the IASB directly.

6. In the process of canvassing the views of IFAC constituents it became clear that a sizable minority believed that the IASB ought to address micro-entities, that is entities at the smaller end of the SME spectrum. Indeed many, and often all, of the clients of the members of some IFAC member bodies consist of micro-entities. To complicate matters further what is taken to be a micro-entity or a SME varies from country to country. IFAC, as detailed in paragraphs 12 to 17, feels that appropriate adjustments to the IASB *Framework for the Preparation of Financial Statements* ('IASB Framework') will enable the IASB's proposals to accommodate all categories of SMEs, from micro-entities through to large unlisted entities.
7. The Discussion Paper poses a number of issues and questions. This submission does not respond to every issue and question, rather it concentrates on the main issues from IFAC's perspective and in some instances presents the alternatives entertained in the process of arriving at this response.

#### GENERAL ISSUES

8. Understandability of IFRSs, and in turn the financial statements based on these standards, is integral to the IASB's goals. To achieve global convergence, IFRSs should be understood by governments and regulators, and by preparers and auditors. If they are not understood, they cannot be rigorously applied or enforced and, therefore, will not help participants in the world's capital markets and other users to make economic decisions.
9. In recognition of the need to develop global standards that are easily understood, the International Audit and Assurance Standards Board ('the IAASB') recently formed a task force charged with the job of enhancing the clarity of its own standards. The issue of clarity is arguably of even greater importance with respect to SMEs since they and their auditors often lack access to the necessary technical expertise. IFAC, therefore, feels that much care needs to be taken in ensuring that the IASB Standards for SMEs are written in a manner that is readily understood by the persons charged with applying them.
10. The IASB's Discussion Paper notes that in some smaller or emerging economy countries, full IFRSs are used as national generally accepted accounting principles or practices (GAAP) for all or many unlisted entities and, consequently, SMEs are required to follow all of the requirements of full IFRSs. It goes on to say that, not only are there many instances of non-compliance but many SMEs cite difficulties or excessive costs in applying full IFRSs. IFAC concurs with these observations. Indeed, those IFAC constituents that are best placed to judge – the accountants and auditors of SMEs – strongly support these views.
11. IFAC believes the general purpose financial statements model is equally appropriate for SMEs as it is for larger entities and that the categories of users of SME financial statements are broadly the same as their larger counterparts. It

considers, however, that the information needs of users (by category) differ markedly in both the level of demand for the information and the priority assigned to it. For example, in some owner-managed entities the owners, by virtue of having direct access to internally generated information, are unlikely to share the same appetite for published financial reports as that of the minority investors of a large listed entity. It comes as no surprise, therefore, to find that full IFRSs are frequently perceived to be less appropriate to SMEs.

12. IFAC believes that cost-benefit should be the key criterion that is used to determine the form and content of financial statements required to be prepared by an entity, irrespective of its size. That is, when the benefits of the information produced exceeds the costs of its production then the financial reporting rules should require the preparation of the information. It is noted that the primary benefits are the fulfillment of the information needs of the users. In the absence of a cost-benefit test any level of user needs, no matter how insignificant, would justify the production of information.
13. IFAC interprets ‘costs’ to mean the costs of preparing, auditing and disseminating the financial statements and ‘benefits’ to be the value of the information contained within the financial statements to the end user. Following from this it can be seen that a consideration of user needs effectively gets subsumed within that of the cost-benefit analysis.
14. The IASB *Framework* does not include an explicit cost-benefit criterion as described in paragraphs 12 and 13 above. IFAC, therefore, encourages the IASB to consider incorporating such a criterion into its existing *Framework*. This should obviate the need to have a separate SME version of the *Framework*, a draft version of which we understand was discussed at the IASB’s meeting of July 20-22, 2004<sup>1</sup>. This would simply make explicit a presumption that should underlie any regulatory action, of which financial reporting rule-making is but one example.
15. The inclusion of an explicit cost-benefit criterion into the IASB *Framework* would enable two sets of standards (and in principle more than two) to be based on the framework, if it is accepted that the distribution and size of benefits and costs differs as between large listed entities and SMEs.
16. It is generally acknowledged, and IFAC fully agrees, that for larger entities the benefits from using financial statements prepared on the basis of full IFRSs exceed the costs. This is true despite the recent increase in the financial reporting burden placed on entities. IFAC considers, however, that as one descends the size scale of entities the benefits diminish more quickly than do the costs and at some point intersect. The result is that for many SMEs the costs exceed the benefits.

---

<sup>1</sup> Per *IASB Update* July 2004.

17. IFAC considers that a key objective, therefore, in the development of IASB Standards for SMEs should be to significantly reduce the costs of preparation, audit and dissemination of financial statements by having a set of SME standards that are less complex than their full IFRS counterparts, both in terms of their substance and the form in which they are written.

#### SHOULD FULL IFRSS BE CONSIDERED SUITABLE FOR ALL ENTITIES?

18. IFAC is of the view that full IFRSs are not suitable for all entities. As indicated in paragraphs 16 and 17 above for the SME sector the costs of complying with full IFRSs are high and likely to outweigh the benefits. From a SME perspective full IFRSs are regarded as unduly complex – for instance they employ complicated measurement and recognition criteria and demand extensive disclosure – and could be written in a simpler and more accessible manner.

#### WHAT SHOULD BE THE OBJECTIVES OF STANDARDS FOR SMES?

19. In general IFAC agrees with the IASB's preliminary views on the objectives of standards for SMEs but, as indicated in paragraph 14 above, also welcomes the inclusion of an explicit cost-benefit criterion into the existing IASB *Framework*. IFAC believes that this should ensure that the reporting burden on SMEs is significantly reduced.

#### WHICH ENTITIES SHOULD APPLY IASB STANDARDS FOR SMES?

20. IFAC agrees with the IASB that in setting standards for SMEs qualitative rather than quantitative "size" criteria should take precedence. Furthermore, IFAC agrees with the use of the public accountability principle to distinguish between SMEs and other entities. That said, IFAC would expect the size threshold component of the public accountability criteria to be set in such a way as to ensure that large unlisted entities would be classified as publicly accountable by virtue of the magnitude of their wider economic impact. IFAC interprets the public accountability principle in its broadest sense including, for instance, the employment supported by the entity, rather than just the financial impact on capital market participants.
21. Some guidance could be provided to assist countries in determining whether or not an entity is economically significant, for example by specifying size criteria based on, say, factors of GDP and other developmental indices. This would ensure a more consistent application of the proposed public accountability criteria from country to country.
22. IFAC considers that it would be useful to have some test that looks at the separation between the owners and the governing body of the entity. This would dispense with the need to have the unanimous consent of the owners to applying SME standards. Such consent is both impractical and undesirable. It is undesirable for two reasons. First, it is doubtful whether all owner-managers or other shareholders of SMEs would understand the distinction between the two standards. They are likely to rely on their external accountant for choices of this

nature. Second, a single independent shareholder of a very small entity could dictate that an entity should publish their financial statements under full IFRSs.

23. The requirement for applying IASB Standards for SMEs could then be as follows: Where the entity is not publicly accountable and all owners are on the governing body then a majority decision of governing body for the organization to apply IASB Standards for SMEs would be sufficient. Where the entity is not publicly accountable and all owners are not on the governing body then a super-majority decision of the governing body for the organization to apply IASB Standards for SMEs would be sufficient. This approach seeks to balance the issues of information asymmetry between owners and the governing body, and the need to have a practical solution.
24. All qualifying entities should be permitted to apply IASB Standards for SMEs for the purpose of preparing their own separate financial statements, providing they have the consent of those entities exercising control over them and subject to regulations imposed by the relevant national jurisdiction.

#### FULL IFRSS FALL BACK OR OPTIONAL REVERSAL

25. IFAC's view is that the standards applicable to an organization should be applied in their entirety, except in rare circumstances where it is concluded that it would be misleading or a departure is necessary to achieve fair presentation.
26. IFAC recognizes that some SMEs may have compliance with certain IFRSs imposed on them by bankers and lenders. This, however, should not be used as justification for permitting all SMEs to switch between full IFRSs and their SME equivalents and by so doing imposing a chaotic framework on all SMEs. Rather such SMEs should also prepare special purpose financial statements tailored to their lenders' specifications.

#### BASIS FOR THE DEVELOPMENT OF IASB STANDARDS FOR SMEs

27. IFAC agrees with the approach proposed whereby IFRSs are the starting point for developing SME standards. However, as explained in paragraphs 12 to 17 above IFAC believes that the IASB *Framework* should incorporate an explicit cost-benefit criterion and that this single *Framework* should guide the development of both full IFRS and their SME counterparts.
28. While the development of a revised IASB *Framework* will assist in the development of a core set of SME standards, it is not considered necessary to have finalized such a *Framework* prior to developing SME versions (equivalents) of each of the existing full IFRSs. In some cases a SME equivalent may not be necessary. It is pleasing to note that the IASB has already discussed draft SME versions of three standards at its meeting of July 20-22, 2004<sup>2</sup>.

---

<sup>2</sup> Per *IASB Update* July 2004.

29. Thereafter, as and when a new topic is identified for a proposed new standard then a full IFRSs and a SME version ought to be developed in parallel.

#### MODIFICATIONS TO CONCEPTS AND PRINCIPLES

30. As mentioned in paragraphs 12 to 17 IFAC believes that when the IASB formulates the SME version of the initial set of core SME standards any modifications to the concepts and principles in the full IFRSs must be on the basis of a cost-benefit test.
31. IFAC accepts that the execution of such a test poses problems. The costs are relatively easy to identify, being in the main conspicuous and tangible. The benefits, on the other hand, being largely less obvious and intangible, may be difficult to identify let alone quantify. Research into user needs, or at least reference to the relevant research literature, will assist with the identification and valuation of the benefits.
32. IFAC anticipates that significant modifications will be needed to disclosure and presentation requirements as well as modifications to measurement and recognition principles if SME standards are to pass the cost-benefit test.
33. IFAC disagrees with the IASB's rebuttable presumption that no modifications should be made to recognition or measurement principles. Rather the decision as to which recognition and measurement principles should be used in SME standards ought to rest on the application of a cost-benefit test. IFAC suspects that in the absence of simplifications to the measurement and recognition principles it is likely that the overall burden of IASB Standards for SMEs will only marginally be reduced vis-à-vis full IFRSs. Therefore, it is presumed that for some IFRSs there will be a need for changes to be made to the recognition and measurement principles.

#### FORMAT OF IASB STANDARDS FOR SMEs

34. IFAC believes the appropriate format for IASB Standards for SMEs is for them to be printed in a separate volume, made available online, be organized by IAS/IFRSs number, and include a statement of its objective and a summary.

#### CONCLUDING COMMENTS

35. IFAC very much welcomes the IASB's decision to address the issue of accounting standards for SMEs and finds itself substantially in agreement with the preliminary views set out in the Discussion Paper.
36. Given the widespread and strong support for this initiative amongst IFAC's constituents IFAC feels the project deserves high priority and encourages the rapid resolution of the initiative, subject of course to the requirements of proper due process.

Please do not hesitate to contact me (tel. +1 (212) 286-9655, email. [ianball@ifac.org](mailto:ianball@ifac.org)) should you wish to discuss any of the matters raised in this submission.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ian Ball', with a stylized, cursive script.

Ian Ball  
Chief Executive

cc: IFAC Small and Medium Practices Permanent Task Force  
IFAC Developing Nations Permanent Task Force  
IFAC Board