CL 28

Preliminary Views on Accounting Standards for

Small and Medium-Sized Entities

Submission from:
National Public Practice Committee
Institute of Chartered Accountants of New Zealand

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IASB Issue 1. Should the 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?

No. IFRSs were specifically developed for large reporting entities. SME's have different types of users with different information needs and different levels of understanding.

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

For SME's, we believe the financial reporting standards should be set by the national bodies. In New Zealand this should be the Institute of Chartered Accountants of New Zealand.

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 IASB), even if national law or regulation were to permit this? 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?

Yes. We feel the definition of public accountability is too wide and will include small charitable and educational organisations. We believe national bodies should have discretion, for example, using size as criteria.

Second Question: Agree.

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

Question 2. Are the objectives of the IASB Standards for SMEs as set out in preliminary view 2 appropriate and, if not, how should they be modified?

In a purest sense, we agree with the objectives. However we have real concerns about the financial reporting standards for SME's being based on the same conceptual framework as IFRSs. The IFRSs framework may not be appropriate or meaningful for SME's. We would need to see the details prior to making any further comment.

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

Question 3a. Do you agree that the IASB 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?

Yes, the IASB should describe the characteristics of entities for which it intends the SME's standard.

Question 3b. Do you agree that the IASB should develop standards that would be suitable for <u>all</u> 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?

Agree in principal, but the national authorities must have discretion as to the application of the standard. Certain entity types do not fit a normal profit orientated entity eg. Trusts and charities. **"One size does not fit all".**

*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?

Believe the definition is too broad as it requires some small entities to comply with full reporting. The cost of compliance would exceed the benefits of public accountability. We recommend the definition outlined in the New Zealand, Ministry of Economic Development's report for Tier I entities is more appropriate. (refer Appendix 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? If not, why not?

We disagree on just one owner being able to require full IFRS reporting. We feel a threshold of 25% is appropriate, however we are not sure how this can be applied to family trusts and some not-for-profit organisations etc.

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?

Disagree. A subsidiary under this proposal is required to prepare full IFRS financial statements. The present practice of providing full disclosure information by way of additional schedules is adequate.

IASB 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?

Agree.

IASB 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 an SME should be able to apply an individual IFRS providing it is fully disclosed.

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)

(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, f you favour (c), what criteria do you propose for defining "related" principles.

Choose (a). This would appear to be the safest approach.

IASB Issue 6. How should the IASB approach the development of IASB Standards for SMEs?

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?

Agree. Our experience in New Zealand of starting with extracting the fundamental concepts from the framework has worked well.

IASB Issue 7. If IASB Standards for SMEs are built on the concepts and the 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 analysis? If not, what alternative bases for modifications would you propose, and why? And, if so, do you have suggestions about how the IASB might analyse the costs and benefits of IFRSs in an SME context?

We believe "the modifications for SME's to the concepts of principles in full IFRSs must be on the basis of the identified needs of users of SME financial statements **AND** cost benefit analysis".

We suggest the IASB consult with major users of SME's including Inland Revenue Departments and Financial Institutions.

Question 7b. Do you agree that it is likely that disclosure and presentation modifications will be justified based on 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?

Yes.

Question 7c. Do you agree that, in developing Standards for SMEs, the IASB 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?

No. There is an expectation that modification will be made to the recognition or measurement principles in IFRSs for SME's. Examples of this are possible exemption for deferred tax, cash flow and financial instruments.

IASB 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 Interpretation) or some other approach, please explain why.

Separate printed volume, however if the information can be filtered into IFRS for SMEs, then it can be incorporated with the IFRS.

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.

Should be matched to the IFRSs.

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

Yes

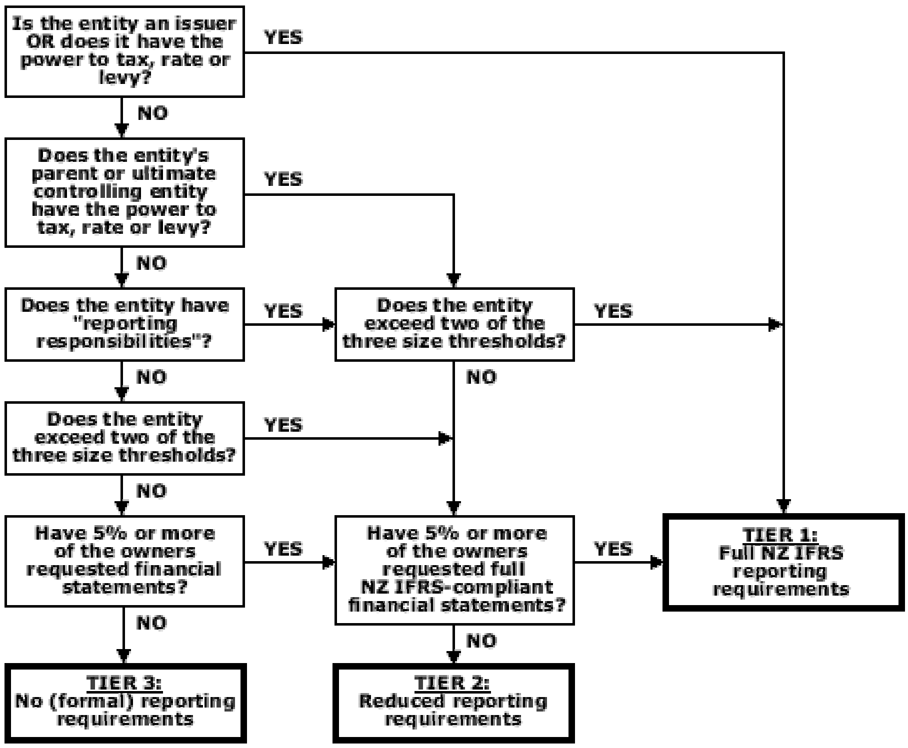
Question 9. Are there any other matters related to how the IASB should approach its project to develop standards for SMEs that you would like to bring to the IASB's attention?

Please focus the development of SME standards on the cost benefit and the specific users of those statements.

Appendix 1

(Extract from the "Review of the Financial Reporting Act 1993: Part I: The Financial Reporting Structure" released by the Ministry of Economic Development, New Zealand, March 2004)

Figure 2: The Proposed Financial Reporting Framework



111. As per the current financial reporting framework, the proposal identifies three tiers of reporting requirements. A combination of the proposed proxies would determine the tier of any given entity. Tier 1 entities would be required to comply with the full reporting requirements of New Zealand IFRS, and would comprise:

- Issuers;
- Entities with a coercive power to tax, rate or levy;
- Large entities controlled by entities with a coercive power to tax, rate or levy;
- Large entities with reporting responsibilities; and
- Entities that would otherwise be in tier 2, but five per cent or more of the owners, shareholders or stakeholders request full financial statements.

112. Tier 1 entities would include listed companies, government departments, and large widely held companies (though not listed). It would also include large charities and clubs.

113. Tier 2 entities would also be required to produce reports, but with some relief from the full disclosure requirements (to be determined by the ASRB[66]). This category would comprise:

- Small public sector entities, unless its controlling entity requests full financial statements, in which case the entity would shift to tier 1;

- Small entities (despite otherwise having reporting responsibilities), unless five per cent or more of the owners, shareholders or stakeholders request full financial statements as above

- Large entities without reporting responsibilities, unless five per cent or more of the owners, shareholders or stakeholders request full financial statements as above; and

- Entities that would otherwise be in tier 3, but five per cent or more of the owners, shareholders or stakeholders request financial statements.

114. Tier 2 entities would include smaller public sector entities (in particular, schools). Significantly, it would also incorporate smaller entities such as clubs,[67] and large closely held companies. This is a significant departure from current requirements. Large, closely held companies are subject to the full requirements of financial reporting under current New Zealand law, and the proposal would reduce their obligations.

115. Finally, tier 3 entities would have no formal reporting requirements beyond the Companies Act requirements, subject to five per cent or more of the owners, shareholders or stakeholders requesting financial statements. This reflects general feedback on the October 2002 Ministry of Economic Development Discussion Document on the Exempt Companies Regime.[68] Submissions generally supported the removal of any formal reporting requirements from the Financial Reporting Act as an unnecessary compliance cost, given the perception that the reports produced were of limited use.

116. Typical tier 3 entities would include all entities that are owned or represent only a few people, and would include a significant proportion (probably in excess of 90 per cent) of entities in New Zealand, including virtually all small businesses.