


Exposure Draft on IFRS for SMEs: Is this the right answer?

July 2008



INTRODUCTION

In February 2007 the International Accounting Standards Board (“IASB”) published for public comment the exposure draft of its International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). With the IASB planning to issue a final IFRS for SMEs in 2009, the debate around this exposure draft is starting to mount.

The objective of this project is to develop an IFRS which provides a simplified, self-contained set of accounting principles to meet the financial reporting needs of non-listed companies.

IFRS are developed primarily for listed companies. The IASC Foundation sets as one of its primary objectives *“to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world’s capital markets and other users make economic decisions”*.¹

As illustrated in the IASB’s full Q3 2007 edition of *INSIGHT* *“when the IASB was set up in 2001 the Trustees told the Board that it should deal with the world’s capital markets.”* That was the focus that has led to the implementation of IFRS for listed companies in Europe and around the world and has now opened up the possibility of IFRS becoming the world’s accounting language. To get there has been an immense achievement. But it has been a different focus from that of the IASB’s predecessor standard-setting body, IASC, which was charged with producing accounting standards that attempted to be relevant to all companies, not just listed ones.”²

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In order for IFRS to be accepted worldwide as a truly international set of standards it is still necessary to address the special needs of non-listed entities. In particular, pressure for such an initiative came from emerging economies. As a result the SMEs project was developed.

The primary focus of RSM International is to serve mid-sized internationally active growing companies around the globe. Clearly, the IFRS for SMEs is going to have a significant impact on our clients as well as on our organisation.

If the debate is constructive it will result in the acceptance of a solution that will allow constituents from all over the globe to enlarge the population of entities that adopt IFRS. This project might result in being the definitive acknowledgement of IFRS as “The set of global financial reporting standards”.

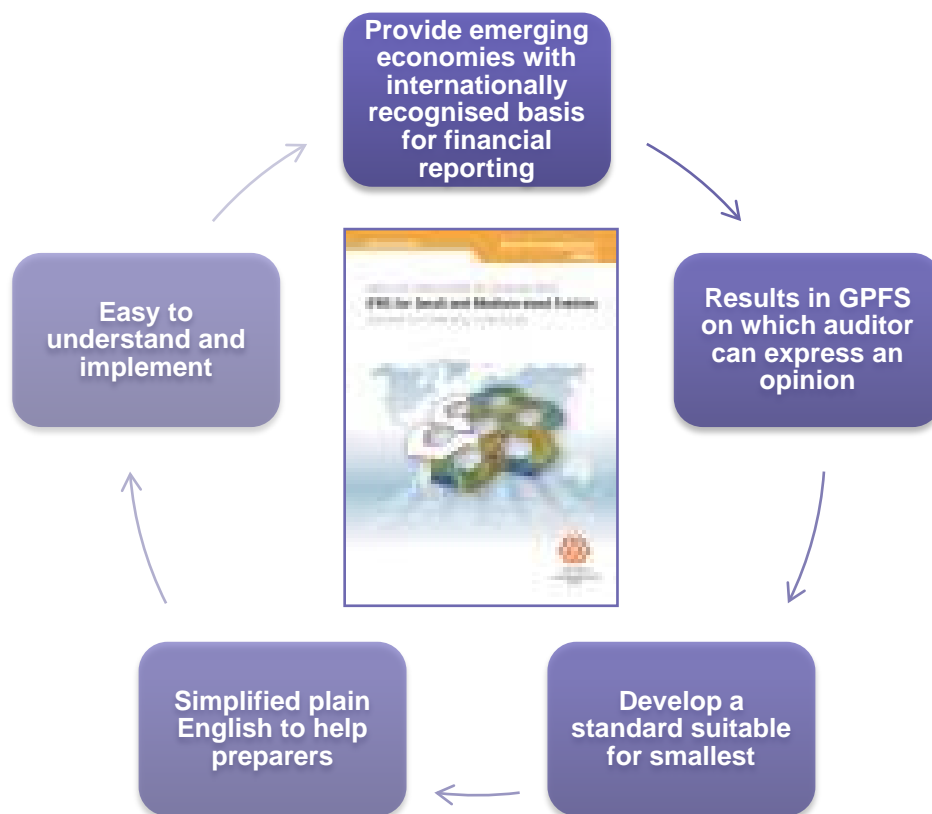
Now that the direction of the IASB is clear, constituents have had some time to digest the proposals and the debate has reached a significant level of maturity, we have decided to write this paper in order to illustrate the current position and to discuss the remaining unresolved issues.

1: IASC Foundation Constitution, approved by the Members of IASC at a meeting in Edinburgh, Scotland on 24 May 2000 and revised by the IASC Foundation Trustees on 5 March and 8 July 2002, 21 June 2005 and 31 October 2007

2: Source: *INSIGHT*, the quarterly journal from the International Accounting Standards Board (IASB) and IASC Foundation, Q3 2007

In designing this new set of IFRS for SMEs, the IASB has been driven by the following overarching principles:

- Provide emerging economies with an internationally recognised basis for financial reporting
- Result in general purpose financial statements (GPFS) on which an auditor can express an opinion
- Use simplified plain English to assist preparers' understanding
- Develop a standard suitable for the smallest entities which is easy to understand and implement



1) Definition of SMEs

One of the major issues addressed by the project was to decide to what population of preparers the IFRS for SMEs should be applicable.

In this respect the IASB decided not to develop detailed guidelines on which entities should or should not be eligible to use the IFRS for SMEs. This is considered an issue to be addressed by national jurisdictions.

The IASB proposed that IFRS for SMEs is intended for entities with no public accountability and consequently developed the concept of public accountability, which resulted in the following main features:

- Entities that have issued debt or equity securities in a public market; or
- Entities that hold assets in a fiduciary capacity for a broad group of outsiders. Examples of such an entity include a bank, an insurance company, a securities broker/dealer, a pension fund, a mutual fund and an investment bank.

The next stage was to determine whether all the entities without public accountability should apply the IFRS for SMEs or only a portion of them. If the target is only a portion of them, on what basis should that portion be determined?

Because of the huge diversity among countries around the world, the IASB concluded that “one size does not fit all” and therefore the IASB convened that it is a matter for each jurisdiction to decide which entities without public accountability should apply the IFRS for SMEs.

In determining the content of the proposed IFRS for SMEs, the IASB focused on a typical entity with about 50 employees. The IASB’s goal in doing so was to make the IFRS for SMEs a stand-alone document for such typical SMEs, and also for entities smaller than 50 employees.

In determining the content of the proposed IFRS for SMEs, the IASB focused on a typical entity with about 50 employees.

The IASB used the 50-employee guideline not as a quantified size test for defining SMEs but rather to help it to determine the kinds of transactions, events and conditions that should be addressed in the IFRS for SMEs.

In some jurisdictions, all limited liability companies are required to publish general purpose financial statements. In other jurisdictions, such a requirement is not imposed on very small entities and small entities can decide to use a simplified reporting system or even to simply comply with tax requirements.

The IASB concluded that this is not a decision for the IASB. It is a public interest issue that must be addressed by legislators and regulators jurisdiction by jurisdiction. Where an entity that does not have public accountability is required to prepare general purpose financial statements, or chooses to do so, the proposed IFRS for SMEs is appropriate because it has been tailored to the needs of such a company.

In other words, the IASB has decided to allow individual jurisdictions to decide where to set the bar of applicability of IFRS for SMEs and therefore, *de facto*, the issue of micro entities, as we will discuss later on, has to be addressed by each individual jurisdiction.

Some constituents are concerned about the fact that, despite the simplifications, IFRS for SMEs is still too complex for micro entities. As a result, it would be impractical to push them down to micro entities. This inevitably would result in a three-level differential reporting system:

1. Full IFRS for listed entities and other publicly accountable entities
2. IFRS for SMEs for non public entities, except for micro entities
3. Micro entities would apply local GAAP or other local regulations

This three-level differential reporting system is already in place or in the process of being implemented in some countries (i.e. UK, Canada, Australia and New Zealand)³.

For instance, the Canadian Accounting Standards Board's (AcSB)⁴ strategic plan which was adopted in 2006, pursues separate strategies for Canada's major categories of reporting enterprises: publicly accountable enterprises, non-publicly accountable enterprises and not-for-profit organisations.

As noted by the AcSB, *"one size does not necessarily fit all; it may not be possible to address the divergent needs of different categories of reporting entities within a single strategy..."*

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The concern that the proposed IFRS for SMEs does not address the needs of micro entities is particularly felt by the Secretariat of the United Nations Conference on Trade and Development (UNCTAD)⁵ whose view is that *"the Exposure Draft is not suitable for smaller SMEs"* and that *"the Exposure Draft would be applicable to the larger SMEs which would have in-house the necessary accounting and financial reporting expertise as well as related information systems"*.

The UNCTAD explain that *"in assessing the extent to which the proposed Exposure Draft would alleviate accounting and financial reporting burden on SMEs in comparison to full IFRS, it is quite evident that the suitability of the Exposure Draft decreases as one moves further down the range from the relatively larger SMEs to the relatively smaller ones. Thus, the Exposure Draft would be too cumbersome to implement for SMEs at the lower-end of the spectrum. As indicated in our*

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3: In the UK, the Accounting Standards Board ('ASB') issued a consultation paper in respect of IFRS for SMEs ('the Proposed Standard') in April 2007, which expressed that the proposed standard would play a central role in the structure of the accounting requirements for UK and Irish entities. In April 2008, the ASB announced its intention to prepare a discussion paper, due later this year, which is expected to set out the latest proposals on future UK reporting structure consisting of the following three tiers:

1. Full IFRS for entities with public accountability;
2. IFRS for SMEs for the middle tier; and
3. The current UK Financial Reporting Standard for Smaller Entities ('FRSSE').

The ASB accepts that the above structure will need to be looked at carefully in terms of the costs and benefits to UK and Irish companies. In addition there are some complex decisions to be made, not least of which is the transition point between companies applying the FRSSE and the IFRS for SMEs.

In Australia, at its March 2008 meeting, the AASB discussed its tentative decisions made at the December 2007 meeting that there should be two tiers of reporting in respect of for-profit companies:

1. Tier 1: full IFRSs for publicly accountable entities; and
2. Tier 2: a choice for an entity that is not publicly accountable to elect either of the following:
 - the IFRS for SMEs; or
 - full IFRS recognition and measurement requirements plus limited specified disclosures.

The Board considered an issues paper on the second option in tier 2 and decided to defer further consideration of the issues until the final outcome of the IASB's IFRS for SMEs is known. The Board noted that a final decision on its approach depends on the nature and extent of disclosures required by the forthcoming IFRS for SMEs. The Board will now progress the project in relation to differential reporting for not-for-profit entities.

4: Source: comment letter of the Canadian Accounting Standards Board's (AcSB)

5: Source: comment letter of the Secretariat of the United Nations Conference on Trade and Development (UNCTAD), 30 November 2007

responses to the IASB's Discussion Paper and Staff Questionnaire on this topic, we are of the view that in responding to the accounting and financial reporting needs of SMEs, a three-tier approach to categorization of SMEs would provide a more practical solution. Even though the IASB might not intend to develop a separate standard for the smallest SMEs, recognizing that their needs differ from those of the larger SMEs would have helped in gauging better for what size entities the Exposure Draft is intended for."

However, concerns are not limited to the applicability to micro entities, but also to large private entities. As highlighted in its comment letter by the British Private Equity and Venture Capital Association (BVCA)⁶, *"although the majority of private companies may be of equivalent size [50 employees] there are also a significant number that are much bigger and have more complex trading and financial relationships"*. We might therefore have private entities that in terms of size and relevance are similar to listed entities and competing with them but that would be allowed to use a lighter version of IFRS.

On this basis, it appears that the issue of which entities should apply IFRS for SMEs, and even if the name "IFRS for SMEs" is appropriate is not yet resolved and will affect the future development of the proposal. In fact, in a recent speech, Sir David Tweedie said that: *"We're even thinking of changing the name to 'Private companies'". Tweedie says that such a decision "could just be a catalyst that helps encourage the adoption of the stripped-down standard by private companies large and small even including subsidiaries of quoted companies, though he thinks that the consolidation of subsidiary accounts might prove easier if they were on full IFRS. But even 'Private IFRS' would be easier than the current situation in which many companies still use local, national GAAP below group level."*⁷

"We're even thinking of changing the name to 'Private companies'".

Soon after Tweedie released this interview, the International Accounting Standards Board met in London on 19 – 23 May and it was decided that the title of the standard should be changed to International Financial Reporting Standard for Private Entities, with private entities defined similarly to the definition of SMEs in the Exposure Draft.

Ultimately, the success of IFRS for SMEs depends on whether the IASB will be able to develop a set of standards that appeal to SMEs – or private entities - which proves to be beneficial to the business community as a whole. In this respect there are still mixed feelings. There are countries that are very enthusiastic about that, like South Africa – see section 7 below - and other developing countries. But at the other extreme, in some countries there are some constituents that are not in favour of the idea of IFRS for SMEs. For instance in Germany, where the Association of German Chambers of Industry and Commerce highlight that *"only a minority of SMEs is definitely interested in the development of IFRS for SMEs. Also if they have cross-border activity - they still prefer local GAAP. Only a few participants in surveys on IFRS see a need for the international accounting for SMEs. This could be shown by surveys of DIHK in 2005 and by a common survey in cooperation with other German organisations in 2007"*.

"Only a minority of SMEs is definitely interested in the development of IFRS for SMEs."

6: Source: comment letter of British Private Equity and Venture Capital Association (BVCA), 1 October 2007

7: Source: interview to "Sir David Tweedie, IASB chairman" from the Financial Director, 26 March 2008

Based on the analysis of the comment letters that we conducted and summarise with a collection of some excerpts in section 7, it appears that the task of the IASB to find the right compromise will be a huge challenge and therefore it is likely and inevitable is that the final document will leave many constituents not entirely satisfied.

2) Why a set of standards specifically designed for SMEs?

The significance of benefits that a common set of global standards can bring to the economic environment is somewhat self-evident. The premise behind IFRS for SMEs is to extend all those benefits to individual SMEs as well.

The major benefits to the economy of a common set of global standards are listed below.

Information quality

The accounting standards for SMEs in many countries have not been developed with the needs of lenders, vendors and other external users in mind. This has limited small companies' access to capital or, at a minimum, raised the cost of capital, particularly in small and developing countries. In jurisdictions that require small companies to use full IFRS, the quality of implementation is often problematic.

Comparability

High quality global financial reporting standards enhance the comparability of financial information. The lack of comparability in global markets is not only an issue for listed companies. The world's business markets are highly integrated, even for smaller companies.

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Decision-usefulness as the overriding principle

The benefits of the IASB's proposed IFRS for SMEs go beyond comparability. It is likely to improve the quality of financial reporting by SMEs in many jurisdictions because, often, the standards that SMEs are currently following may not have been designed with decision-usefulness as the overriding objective.

The proposed IFRS for SMEs is designed to produce general purpose financial statements that are useful for economic decision-making by a broad range of resource providers to SMEs, such as non-manager owners, lenders, vendors and other creditors, customers and employees.

Capital allocation

A common set of global standards should improve the efficiency of allocation and the pricing of capital. This benefits not only the providers of debt or equity capital but also those entities that seek capital, because it reduces their compliance costs and removes the uncertainties that affect their cost of capital.

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In most jurisdictions many, or even all, entities have a statutory obligation to prepare financial statements that conform to a required set of local GAAP. Often, an audit is required by law (with micro companies often exempted). Those statutory financial statements are normally filed with a government agency or put on a website and thus are available to creditors, suppliers, employees, governments and others.

SMEs have different needs compared to listed entities

Because full IFRS was designed to meet the needs of equity investors in companies in public capital markets, they cover a wide range of issues, contain a sizeable amount of implementation guidance and include disclosures appropriate for public companies.

Users of the financial statements of SMEs do not have those needs, but, rather are more focused on assessing shorter-term cash flows, liquidity and solvency.

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Meet user needs without excessive burden for preparers

Many SMEs complain that full IFRS imposes a burden on them. Such a burden has increased as IFRS has become more detailed and more countries have begun to use it. Thus, in developing the proposed IFRS for SMEs, the IASB's dual purpose was to meet user needs whilst balancing costs and benefits from a preparer perspective.

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As IFRS has gained greater acceptance around the world, many jurisdictions have adopted it or have developed national GAAP based on IFRS. Today, IFRS is either required or permitted in over 100 jurisdictions. For private companies, some 20 jurisdictions require full IFRS for all, another 25 jurisdictions require them for some, while another 34 jurisdictions permit (rather than require) SMEs to use full IFRS. Many other jurisdictions that do not require IFRS directly are increasingly converging their national standards with IFRS, which means that, *de facto*, IFRS is being "pushed down" to SMEs, which often don't have the expertise or ability to bear the costs of complying with full IFRS.

Audit quality and training

Global standards also improve consistency in audit quality and facilitate education and training.

Other shortcomings

Many jurisdictions lack country-specific textbooks, guidance, training materials and software for implementing national standards. This diminishes comparability even within a jurisdiction, as different requirements are interpreted differently. National standards mean that jurisdiction-specific auditing methodologies are needed. Developing national standards is costly.

So far we have listed the major general benefits that IFRS for SMEs would bring the business community as a whole. We now analyse in depth potential advantages for different categories of users in having a common set of global standards.

Financial institutions

In many jurisdictions it is common for SMEs, including very small entities, to have bank loans. Many banks operate across borders and rely on financial statements in making lending decisions, in establishing terms and interest rates and in monitoring loans. In addition, banks require data they can understand and compare.

Vendors

Vendors want to evaluate the financial health of buyers before they sell goods or services on credit. This is especially true when the buyer is a small or medium-sized entity. Similarly, buyers use a supplier's financial statements to assess the prospects of a viable long-term business relationship.

Many businesses have overseas suppliers and use a supplier's financial statements to assess the prospects of a viable long-term business relationship. The supplier is often a small or medium-sized entity.

Credit rating agencies

Credit rating agencies try to develop ratings uniformly across borders. Similarly, banks and other institutions often develop ratings in the same way as credit rating agencies. Reported financial figures are crucial to the rating process.

Venture capital firms

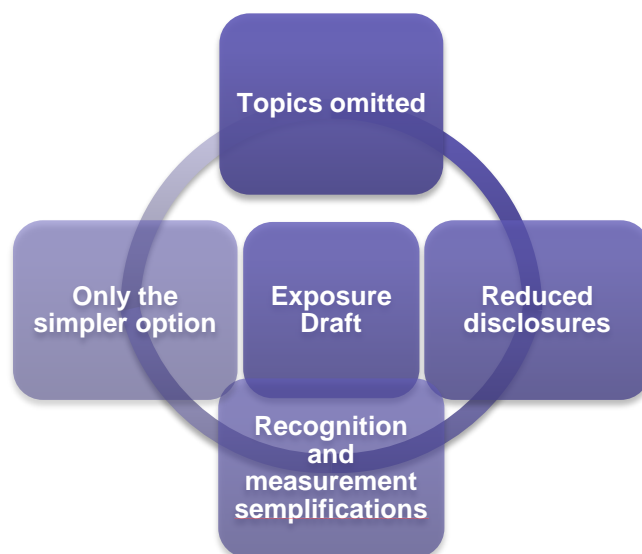
These firms provide funding to SMEs across borders. Many SMEs have external investors who are not involved in the day-to-day management of the entity. Global accounting standards for general purpose financial statements and the resulting comparability are especially important when those outside investors are located in a different jurisdiction from the entity and when they also have interests in other SMEs.

Global, regional and national development institutions

These institutions provide financial assistance to entities in developing countries around the world. They rely on financial statements to make financing decisions and to assess financial results. Accounting differences reduce understandability, obscure comparisons and lead to sub-optimal decisions.

3) IFRS for SMEs: the cornerstones

The idea of developing a self-contained set of accounting standards that would allow investors for the first time to compare SMEs' financial performance across international boundaries on a like for like basis is based on the following main cornerstones:



- **Retaining the same IASB Framework.** The draft IFRS for SMEs has been developed by extracting the fundamental concepts from the IASB Framework for the Preparation and Presentation of Financial Statements and the principles and related mandatory guidance from IFRS with appropriate modifications in the light of users' needs and cost-benefit considerations.
- **Stand-alone document.** The Board intends the IFRS for SMEs to be a stand-alone document for a typical SME with about 50 employees. That is, it will cover the kinds of transactions and other events and conditions that companies of that size are likely to encounter. The “50 employees” concept was a guide to the Board in determining the content of the IFRS for SMEs. However, it is not intended as a quantified size test for defining an SME, though jurisdictions adopting the IFRS for SMEs may add one.
- **There is no mandatory fallback to full IFRS.** We will analyse this topic in detail in section 5.
- **Modifications to IFRS.** We will analyse this topic in detail in section 4.
- When published in printed form, IASB SME standards will be **organised topically**, such as in balance sheet and income statement order, rather than having an equivalent SME standard for each IAS and IFRS number. However, the topical standards would be cross-referenced to the equivalent IAS/IFRS

4) Modifications: an overview

The modifications are of four broad types based on the needs of users of SMEs' financial statements and cost-benefit considerations:

i. Eliminating topics that are not generally relevant to SMEs - Topics omitted

The following topics in full IFRS are considered not relevant to a typical SME and are therefore omitted from the proposed IFRS for SMEs, with cross-references to the relevant IFRS if needed:

- General price-level adjusted reporting in a hyperinflationary environment.
- Equity-settled share-based payment (the computational details are in IFRS 2 Share-based Payment)
- Determining the fair value of agricultural assets (look to IAS 41 Agriculture, but the exposure draft also proposes to reduce the use of fair value through profit or loss for agricultural SMEs)
- Extractive industries (look to IFRS 6 Exploration for and Evaluation of Mineral Resources)
- Interim reporting (look to IAS 34 Interim Financial Reporting)
- Lessor accounting for finance leases (finance lessors are likely to be financial institutions that would not be eligible to use the proposed IFRS for SMEs)
- Recoverable amount of goodwill (SMEs would test goodwill for impairment much less frequently than under IAS 38 Intangible Assets, but if required to perform such a test would look to the calculation guidance in IAS 38)
- Earnings per share and segment reporting, which are not required disclosures for SMEs
- Insurance contracts (insurers would not be eligible to use the proposed IFRS for SMEs)

ii. *Removing choices for accounting treatment - Only the simpler option included*

Where full IFRS provides an accounting policy choice, only the simpler option is in the proposed IFRS for SMEs. SMEs are permitted to use the other option by cross-referencing to the relevant IFRS.

The simpler options selected are:

- The cost-depreciation model for investment property. Recognition using fair value through profit or loss is permitted by reference to IAS 40 *Investment Property*.
- The cost-amortisation-impairment model for property, plant and equipment and intangibles. Using the revaluation model is allowed by reference to IAS 16 *Property, Plant and Equipment* and IAS 38.
- Treating borrowing costs as expenses. The capitalisation of borrowing costs is allowed by reference to IAS 23 *Borrowing Costs*.
- The indirect method for reporting operating cash flows. The direct method is allowed by reference to IAS 7 *Cash Flow Statements*.
- All grants at fair value or SMEs can use any of the alternatives in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

Interestingly, in adopting the IFRS for SMEs an individual jurisdiction could decide not to allow the option that is cross-referenced to the full IFRS. For example, a jurisdiction in which reliable measures of the fair value of property, plant and equipment are difficult to obtain could allow only the cost-depreciation-impairment model and prohibit the revaluation model. SMEs would still be able to assert compliance with the IFRS for SMEs.

iii. *Simplifying methods for recognition and measurement - Recognition and measurement simplifications*

Here are some major examples:

- Financial instruments: an entity shall choose to apply either the provisions of Section 11⁸ of IFRS for SMEs or IAS 39 in full to account for all of its financial instruments. This is an accounting policy choice.
- Classification of financial instruments: two categories of financial assets rather than four. This means that there is no need to deal with all of the 'intent-driven' held-to-maturity rules or related 'tainting' and no need for an available-for-sale category, and many other simplifications.
- Derecognition of financial assets: a simpler principle for derecognition. If the transferor has any significant continuing involvement, financial assets are not derecognised. The complex 'pass-through testing' and 'control retention testing' of IAS 39 are avoided.
- Simplified hedge accounting. Section 11 specifies the risks and the hedging instruments for which hedge accounting is permitted. Periodic recognition and measurement of hedge ineffectiveness is still required, but under less strict conditions than those in IAS 39. In particular, ineffectiveness is recognised and measured at the end of the financial reporting period. The short cut method that is in the US standard SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* is not allowed.
- Goodwill impairment: preparers follow an indicator approach rather than mandatory annual impairment calculations. The definition of recoverable amount has changed. In

8: Section 11 – Financial Instruments includes all the accounting requirements for financial instruments. It represents the equivalent of the combined IAS 32, IAS 39 and IFRS 7.

IAS 36 recoverable amount is defined as the higher of the asset's fair value less costs to sell and its value in use, whereas in section 26 of IFRS for SMEs it is limited to being fair value less costs to sell. As a result the determination of value in use has been removed.

- Recognition of research and development costs: an entity shall choose either the expense model or the capitalisation model as its accounting policy.
- Associates: in addition to the equity method, an investor can account for its investments in all associates using the cost model or the fair value through profit or loss model.
- Joint ventures: in addition to the equity method and proportionate consolidation a venturer can account for its interest in all jointly controlled entities using the cost model or the fair value through profit or loss model.
- Less fair value for agriculture. Fair value is used only if "readily determinable without undue cost or effort".
- Defined benefit plans. The IASB has opted for a more principles-based approach rather than the detailed calculation and deferral rules of IAS 19 *Employee Benefits*. The complex "corridor approach" is omitted and therefore all costs are charged to the income statement. However the actuarial valuation is still performed using the projected unit credit method.
- Share-based payments are measured using the requirements of IFRS 2. In terms of measurement of the value of the awards granted, the intrinsic value method can be used if the entity is unable to estimate reliably the fair value of the equity instruments granted at the measurement date.
- Finance leases: at the commencement of the lease term, lessees shall recognise the rights and obligations under finance leases as assets and liabilities in their balance sheet at amounts equal to the fair value of the leased property determined at the inception of the lease. The recognition using the present value of minimum lease payments, if lower, is not required.
- First-time adoption: less prior period data would have to be restated than under IFRS 1 *First-time Adoption of International Financial Reporting Standards*.
- Deferred taxes approach: the temporary difference approach is retained. However, temporary difference is explained in terms of "timing differences plus approach". Deferred taxes are explained using timing differences.
- Deferred tax recognition exceptions: the exception to recognition of deferred taxes on undistributed earnings of domestic subsidiaries, branches, associates and joint ventures has been removed. Also the exception to recognition of deferred tax assets or liabilities for temporary differences associated with the initial recognition of assets or liabilities outside a business combination has been removed, but on initial recognition of goodwill the exception to recognition of deferred tax liabilities has been retained.

iv. Deleting the many disclosures in full IFRS that are designed for public capital markets, and redrafting into plain English to enhance clarity - Disclosure reductions

The disclosure requirements in the proposed IFRS for SMEs are substantially reduced when compared with the disclosure requirements in full IFRS.

Accompanying the exposure draft is implementation guidance including a checklist of all of the proposed disclosure requirements.

The reasons for the reductions are of four principal types. Some disclosures are not included:

- Because they relate to topics covered in IFRS that are omitted from the proposed IFRS for SMEs
- Because they relate to recognition and measurement principles in full IFRS that have been replaced by simplifications in the proposed IFRS for SMEs
- Because they relate to options that are not included in the proposed IFRS for SMEs
- On the basis of users' needs or cost-benefit considerations

Assessing disclosures on the basis of users' needs was not easy because users of financial statements tend to favour more, rather than fewer, disclosures. The IASB was guided by the following broad principles:

- Users of the financial statements of SMEs are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not recognised as liabilities. Disclosures in full IFRS that provide this sort of information are necessary for SMEs as well.
- Users of the financial statements of SMEs are particularly interested in information about liquidity and solvency. Disclosures in full IFRS that provide this sort of information are necessary for SMEs as well.
- Information on measurement uncertainties is important for SMEs.
- Information about an entity's accounting policy choices is important for SMEs.
- Disaggregations of amounts reported on the face of SMEs' financial statements are important for an understanding of those statements.

5) The idea of a stand-alone document and the "fall back" issue

The IASB has designed the proposed IFRS for SMEs as a stand-alone document for typical SMEs with about 50 employees. It therefore covers the kinds of transactions and other events and conditions that companies of that size are likely to encounter. There is no mandatory fallback to full IFRS.

However, if SMEs cannot find the answer to an accounting question directly in the proposed IFRS for SMEs, they should select an accounting policy that results in relevant and reliable information. In making that judgement, they should consider, first, the requirements and guidance in the proposed IFRS for SMEs dealing with similar and related issues.

In other words, they should try to analogise from the guidance given in the proposed IFRS for SMEs for similar transactions. If that does not yield an answer, they should consider the definitions, recognition criteria, and measurement concepts for assets, liabilities, income and expenses and the pervasive principles that are set out in Section 2 *Concepts and Pervasive Principles* of the proposed IFRS for SMEs.

SMEs may choose to look to the requirements and guidance in IFRS, including Interpretations, dealing with similar and related issues, though this is not a requirement.

As we illustrated in the previous session above, for topics omitted and accounting options removed, SMEs can always revert back to full IFRS.

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Because of the topics omitted and the options removed, even though there is no mandatory fallback issue, SMEs will ultimately have to refer both to IFRS for SMEs and the full IFRS. Furthermore, when topics covered by the IFRS for SMEs do not provide enough guidance, inevitably, SMEs will revert back to full IFRS.

The solution of a non-mandatory fallback solution has achieved that goal. However, it appears that the price paid for this pseudo - simplification has been a failure to produce a true stand-alone document.

As well explained by the Institute of Chartered Accountants of Scotland's Accounting Standards Committee⁹, "while the draft IFRS for SMEs itself is short in comparison to the full body of IFRS standards, there is still a great deal of cross-referencing to full IFRS. Ideally, there should be no cross-referencing to full IFRS – this would enhance the quality and usefulness of the standard in the following ways. The current cross-references to full IFRS would impose a considerable additional burden in terms of time and complexity, as companies would require to consider fully the IFRS for SMEs and the relevant IFRS in order to determine which option to use. As the aim of the IFRS for SMEs is to simplify and condense the requirements of full IFRS, the requirements of the full standards should be summarised briefly in the IFRS for SMEs, capturing the key principles relevant to smaller entities. While this would mean that the IFRS for SMEs would be a longer document than currently proposed, it would result in a more workable standard for SMEs to use. The current level of cross-referencing would also mean that two companies applying the standard could have very different financial statements if one of them chose the full IFRS option in the relevant sections of the IFRS for SMEs. Eliminating optionality would be a positive move as it does not aid comparability. We appreciate that eliminating the cross-references to full IFRS will be a major task, and believe that it is likely that the document can continue to be refined and the references to full IFRS reduced over time, as it becomes apparent how the options are used in practice."

Ideally, there should be no cross-referencing to full IFRS – this would enhance the quality and usefulness of the standard in the following ways.

As we will see in section 7 below, the criticisms to the stand-alone document approach taken by the IASB is widespread and therefore one of the major sources of concerns.

6) Critical analysis

The search for a compromise

The overall concept of a set of IFRS for SMEs is to push down IFRS to entities that are typically not listed on a stock exchange.

In general IFRS is considered too complex and onerous for non-listed entities and therefore to effectively expand its use to non-listed entities, some simplifications appear to be necessary.

To some extent the proposed simplifications might be seen as the quest for a compromise between the needs of users and preparers of IFRS financial statements.

9: Source: comment letter Chartered Accountants of Scotland's Accounting Standards Committee, 29 September 2007

Users of financial statements look for useful information to make economic decisions. In this respect, they value extensive disclosures that can provide that information that numbers and accounts alone cannot provide. In particular, the fair value measurement attribute is considered vital in order to reflect the economic reality of the transactions undertaken or incurred by the entity (see section 7 below).

The frameworks of both IFRS and IFRS for SMEs highlight that the “*objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.*”

Users are intended to be the substantial direct beneficiary of useful and relevant IFRS financial statements. Theoretically, they incur the indirect costs of bad economic decisions due to lack of appropriate information.

Users’ needs are the primary factors to be taken into consideration when accounting standards are designed. As a result, it is vital that their comments are considered a major driver when making decisions on the format and content of IFRS for SMEs.

On the other hand, preparers tend to provide required information minimising the effort particularly when considered or perceived as an unnecessary burden. In general, preparing the accounts on an historical cost basis is simpler and requires reduced disclosures and, in general, less effort. Generally speaking, preparers incur the direct costs relating to the preparation of the financial statements and should benefit from the indirect benefit of a reduced cost of capital invested because of highly qualitative financial statements.

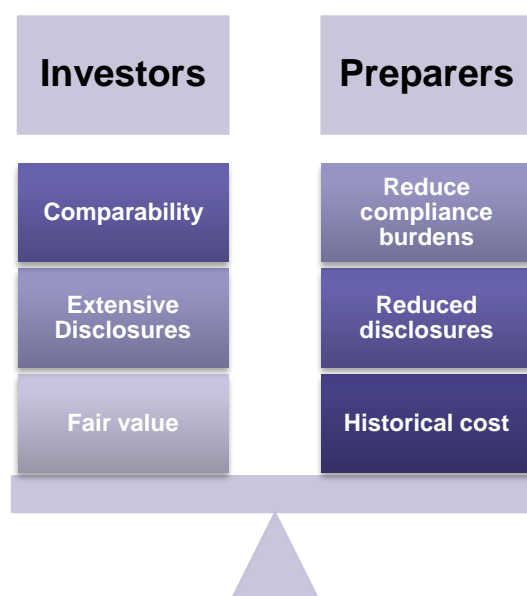
However, this dichotomy is not absolute. In fact, users of IFRS financial statements might be routinely both users and preparers or predominantly preparers and occasionally users or vice versa. As a result it is not appropriate to assume that costs and benefits are analysed as such. However, if it was not the case, there would not be a strong demand for simplification predominantly from constituents that represents SMEs. In fact, as analysed in section 7 below, it is apparent that the case for simplification is primarily supported by preparers or institutions closed to them. Users appear to be less convinced of the necessity for a separate IFRS for SMEs.

In particular, we should consider the view of the CFA Institute who suggests it is questionable whether there is a real need for IFRS for SMEs (see section 7 below).

In any case, this conflict between the needs of users and preparers is not something new and IFRS for SMEs represents yet another chapter of it.

The “objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.”

As a result, it is vital that their comments are considered a major driver when making decisions on the format and content of IFRS for SMEs.



The IASB identified four categories of changes to ease the burden on preparers which are illustrated in section 4 above.

Topics omitted

This modification is based on the idea that to read a 250-page book is easier than to manage a 2,500-page book. In this sense it seems that the view of the IASB is that brevity is perceived as simplicity.

The view of the IASB is that brevity is perceived as simplicity.

We might argue that in the vast majority of jurisdictions local GAAP is applied equally to listed and non-listed entities. If some topics are not relevant it does not matter. The same can be argued for tax legislation.

We might also argue that if from time to time an SME incurs or undertakes transactions that are treated by the omitted standards, it needs to go back to the full IFRS book. In other words, it might be necessary to consult the full IFRS book anyway and thus the SME has to deal with two “books” rather than one.

On the whole, it is difficult to see this as a significant improvement. Brevity does not always mean simplicity.

As highlighted in the comment letter by the Conseil National de la Comptabilité (CNC)¹⁰, *“the simplification of IFRS for SMEs does not just rely on the reduction of the number of pages and the thickness of the volume. If the IFRS for SMEs is to be a “stand alone” document, it should be understandable and readable without preparers having to refer to the “Bound Volume IFRS” in order to draw up the financial statements. Certain*

“The simplification of IFRS for SMEs does not just rely on the reduction of the number of pages and the thickness of the volume.”

¹⁰: Source: comment letter of the Conseil National de la Comptabilité (CNC), 4 October 2007

sections should be completed, by including definitions instead of putting them in the glossary, as well as inserting additional guidance and explanations (see question 4), and illustrative examples adapted to SMEs.”

As highlighted by the Canadian Accounting Standards Board (AcSB) when dealing with “the importance of a reduction in volume”, “*stakeholders do not need to commit the entirety of IFRS to memory. In researching any particular issue, only a limited number of standards need to be considered. Our research suggests that most private companies do not enter into many complex transactions and, thus, they generally do not need to deal with complex accounting issues. With the search capabilities of electronic media it is very simple, and quick, to sift through a large volume of standards material to find what is relevant. In addition, not many of the users that we consulted in our research supported a standalone approach to developing accounting standards for private companies on the basis of the extent of standards material.*”¹¹

“Stakeholders do not need to commit the entirety of IFRS to memory.”

What IFRSs have been used?

As we illustrated earlier when dealing with the simpler accounting options included in the IFRS for SMEs, an individual jurisdiction could decide not to allow the option that is cross-referenced to full IFRS.

In addition, when illustrating the simplification and modifications, we mentioned that for financial instruments and R&D, SMEs are able to go back to full IFRS and with regard to associates, joint ventures new accounting options have been added.

All this creates a multitude of possible combinations, which might seriously impair the comparability of financial statements prepared using IFRS for SMEs.

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In terms of using the accounting policy selection option with regard to “Simplifications and modifications”, IFRS for SMEs and IFRS might overlap, but in certain cases might be inevitably different, depending on the circumstances.

Only the simpler option included

Accounting options allow entities to choose what they consider to be the simpler option. This may not necessarily be the option viewed by the IASB as the simpler option.

It could be argued that the IASB has decided to determine what they consider as the simplest option in order to reduce the volume of IFRS for SMEs. Again, brevity does not always generate simplicity and therefore it is difficult to see this as a significant improvement.

11: Source: comment letter of the Canadian Accounting Standards Board (AcSB), 3 December 2007

In any case because of the option to revert back to full IFRS to apply the omitted option, SMEs preparers will have to compare the accounting option “imposed” in IFRS for SMEs with the accounting options available in the full IFRS volume. This means that in substance SMEs will have to manage the full IFRS volume anyway.

Recognition and measurement simplifications

This modification, combined with the reduction of disclosures, should represent the core of the simplification strategy of IFRS for SMEs.

Theoretically, simplifications should target areas of complexity. Most of the complexity in IFRS arises from the merger of traditional accounting with corporate finance principles and entities operating in more complex and sophisticated environments generally.

Under IFRS, corporate finance has pervasively affected the measurement attribute, as a result of the move to fair value measurement.

For instance, fair value measurement, hedge accounting, derecognition tests, accounting for share-based payments, accounting for defined pension schemes, etc. embed elements of corporate finance which requires the ability to manage mathematical, actuarial, statistical and valuation models.

Corporate finance is a field that does not belong to the conventional background of accountants. If we add the fact that corporate finance has been experiencing a significant development of its own resulting in more advanced and sophisticated mathematical and statistical models, we can easily see how accountants are not always that familiar with it.

Currently IFRS includes some items reported at historic cost while others are measured at fair value, resulting in a so-called “mixed-attribute” system.

SMEs preparers will have to compare the accounting option “imposed” in IFRS for SMEs with the accounting options available in the full IFRS volume. This means that in substance SMEs will have to manage the full IFRS volume anyway.

Most of the complexity in IFRS arises from the merger of traditional accounting with corporate finance principles and entities operating in more complex and sophisticated environments generally.



In other words, the complexity of measurement tools reflects the complexity of the objects to be measured. If the items to be measured are complex, there is little possibility to avoid complex measurement tools.

This complexity is part of the day-to-day business environment.

This complexity is part of the day-to-day business environment. To understand the economic reality of transactions inevitably requires taking that complexity into consideration. Thus, simplification cannot result in a better and fairer view of the economic reality of transactions.

On the whole, it is expected that SMEs are involved in transactions which are less complicated compared to multinational entities. This is why the IASB omitted some topics from the IFRS for SMEs volume. This by itself is the most powerful source of simplification. However, as soon as SMEs become involved in more complex transactions, inevitably the accounting for them becomes more complex. It is not the case that for SMEs the fair value of derivatives is meaningless, or the time value in share based payments does not exist or that mortality tables are not applicable. Market participants would surely consider those elements in making economic decisions.

In terms of fair value measurement, the IASB has substantially maintained the same approach as full IFRS. Fair value measurement is one of the cornerstones on which IFRS has been built and is also one of the most controversial topics which have been a source of fierce criticism. However, the IASB has decided that a set of IFRS for SMEs without a proper fair value measurement approach would compromise too much to simplification of measurement.

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If we look at the simplification introduced to hedge accounting in Section 11, we note that the rules have been tightened in a way that fewer transactions can comply with hedging rules - in this case it seems to be more appropriate to talk about rules rather than principles. As a matter of fact, IAS 39 is closer to a set of rules rather than a set of principles.

The types of transaction that can pass the hedging tests have been narrowed down to those types that, even under full IFRS, were straightforward to account for. This has been achieved by limiting the possibility for preparers to investigate accounting treatments where the answer is not immediate. In other words, SMEs will not have to worry about hedge accounting for certain transactions because it has been prohibited.

We are not convinced that to limit the ability of SMEs to use hedge accounting is the right answer. In addition, under IAS 39, hedge accounting is seen as an option. Entities can always decide not to use it and if accounting complexity is what is worrying them, they can always opt for not using hedge accounting.

Under IAS 39, hedge accounting is seen as an option. Entities can always decide not to use it and if accounting complexity is what is worrying them, they can always opt for not using hedge accounting.

Derecognition has been approached similarly to hedge accounting, where the derecognition test has been simplified in a manner that fewer transactions can pass the test compared to the rules in IAS 39.

If we look at the simplifications relating to defined benefit plans in Section 27, we see that the actuarial valuations as well as all other assumptions of IAS 19 are still there. It means that SMEs are still likely to need to use actuaries when accounting for defined pension obligations. Again, the best and only way to eliminate such complexity is to stay away from defined pension obligations.

It means that SMEs are still likely to need to use actuaries when accounting for defined pension obligations.

Similarly, with regard to share-based payments, a significant part of the complexity resides in the fair value measurement of the awards, and there are no simplifications compared to IFRS 2. Section 25 gives the option of using intrinsic value in cases where the entity is unable to estimate reliably the fair value of equity instrument granted at the measurement date. IFRS 2 gives the same option, but in the Basis for Conclusions it also says that in “*virtually all cases, the estimated fair value of employee share options at grant date can be measured with sufficient reliability for the purposes of recognising employee share-based payment transactions in the financial statements.*”

If the measurement attribute under IFRS 2 and Section 25 is the same, it appears that the use of intrinsic value is “virtually” not allowed.

It is difficult to believe that if a share option award is issued to an employee at-the-money and therefore with an intrinsic value equal to nil, it is totally worthless. However, that is the way it would be accounted for under the intrinsic value method. This does not reflect the economic reality that an entity would not issue an option to employees that would be considered worthless.

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With regard to deferred tax the temporary difference approach is retained but it is explained in terms of “timing differences plus”. Essentially, the “timing differences plus” should be in practice the same as the “temporary difference minus” approach of IAS 12.

In the Basis for Conclusions at paragraph 84, the IASB explains that “*many preparers and auditors of SMEs’ financial statements said that the temporary difference approach to accounting for income taxes in IAS 12 Income Taxes is difficult for SMEs to implement. They said that SMEs do not routinely prepare ‘tax balance sheets’ and generally do not track the tax bases of many assets. Some advocated a ‘current taxes payable’ method of accounting for income taxes, under which SMEs would not recognise deferred taxes.*”

In general, deferred tax is a difficult topic and we assume that it is unlikely that the entities adopting IFRS for SMEs are more familiar with the topic than the entities using full IFRS. We are not sure many people are very familiar with the difference between timing differences and temporary differences, and mixing the two concepts might end up increasing the confusion surrounding deferred tax calculation.

Interestingly, the exception to the recognition of deferred tax assets or liabilities for temporary differences associated with the initial recognition of assets or liabilities outside a business combination has been removed. It means that, for those assets and liabilities, preparers will have to adopt the simultaneous equation method as under U.S. GAAP, as described in EITF 98-11 *Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations*.

We are not convinced that all these modifications will result in a simpler accounting treatment.

Disclosure reductions

The reduction to the disclosure requirements might be quite substantial and will ease significantly the burden for preparers of SME financial statements. However, as we said earlier, disclosures are very important for users of financial statements. They include information that cannot be communicated only by numbers. We are not sure that to drastically reduce disclosures will result in something truly acceptable to users.

Clearly users always look for more information and to draw the line is somewhat complicated, particularly because views of users and preparers are biased by their own interests.

In any case, we note that in general, very often regulators impose on listed entities additional disclosures compared to those required by IFRS or other GAAP. This additional information is considered necessary to safeguard one of the most precious and vital assets around which rotates the core idea of free market: transparency.

Asymmetrical information is one of the major enemies of free markets. It undermines at heart the efficiency of allocation and the pricing of capital.

We live in a society where the importance and the value of information is critical to the everyday personal decisions taken by millions of individuals, let alone economic decisions. It is also important to consider how central and pervasive the economy is in society.

Generally, non-listed companies are less transparent than listed entities. Listed entities tend to be larger and their operations affect a wider number of stakeholders. They have a greater visibility and are therefore pushed to be more transparent. In other words, it means it is somehow easier to gather information about listed entities because there is more information publicly and freely circulating on them compared to private entities.

On the other hand, non-listed entities are less visible to the public and this results in less information available on them and in turn, less transparency. For these companies asymmetrical information might be a significant issue that severely affects business decisions.

Based on the above considerations it seems that there is not much ground to reduce the disclosure requirements for non-listed entities. Theoretically, disclosures should be improved or as a minimum not reduced.

But again, finding the right balance is not an easy task.

We are not convinced that all these modifications will result in a simpler accounting treatment.

Language barrier and familiarity with IFRS terminology

Finally, we would like to support the comment provided by the Conseil National de la Comptabilité (CNC) and German Accounting Standards Board (GASB) which we consider critical for the success of this standard. Generally speaking, SMEs do not operate extensively across-borders as multinational companies do. As a result, they may not have been exposed to IFRS and may not have a proper understanding of the meaning of the IFRS terminology. Under IFRS some words have a very precise meaning, or better, they embed a concept which results from years of debates (i.e. fair value, derecognition, value in use, revenue recognition, more likely than not, etc.).

Understanding the IFRS terminology might be an issue as well as the interpretation of it. In addition, the IFRS for SMEs will be translated in local languages, and this could add confusion for non-IFRS accounting experts.

The CNC in its comment letter says that in its view *“the literal translation of the standard is not readily understandable for preparers and users unless they are already initiated in the application of international standards in the consolidated financial statements of listed groups. It is necessary to find a way to adapt, and not only translate, the standard in different languages in order to be fully explicit to SME which do not necessarily read plain English.”*¹²

“It is necessary to find a way to adapt, and not only translate, the standard in different languages in order to be fully explicit to SME which do not necessarily read plain English.”

The GASB in its comment letter says that *“the general impression is that the ED-IFRS for SMEs is still too complex and not yet sufficiently adjusted to the needs of SMEs and the users of their financial statements. The SME standard is hard to read and to comprehend if read outside the context of full IFRS. In our view there is still a potential to simplify the structure and wording of the IFRS for SMEs, certain measurement and disclosure requirements.”*¹³

The SME standard is hard to read and to comprehend if read outside the context of full IFRS.

7) Comment letters from constituents: an overview

In this section we provide an overview on the comment letters received by the IASB on the exposure draft of the proposed IFRS for SMEs.

We tried to summarise some substantial comments, even though the IASB received more than 160 letters, and given the wide variety of constituents that submitted the letters, it is somewhat difficult to consider them all.

The European Union did not give an enthusiastic initial comment. Charlie McCreevy, European Commissioner for Internal Market and Services said that *“the feedback we have received from Member States, the European Parliament and stakeholders is that the current IASB draft is not*

12: Source: comment letter of the Conseil National de la Comptabilité (CNC), 4 October 2007

13: Source: comment letter of the German Accounting Standards Board (GASB), 14 December 2007

simple enough to be applicable for the bulk of SMEs in the EU. At this stage, therefore, I do not intend to propose that the IASB draft be endorsed for application in the EU".¹⁴

Another authoritative European opinion on IFRS for SMEs comes from the EFRAG. The comment letter is very technical and detailed. Some significant issues that they raise (and that are generally proposed by many other comment letters) focused on the fallback issue, use of fair value and the need for further simplifications.

EFRAG believes that *"all remaining cross-references, both optional and mandatory, should be eliminated"*.¹⁵

"All remaining cross-references, both optional and mandatory, should be eliminated".

In terms of fair value *"EFRAG believes that market prices should be used for the revaluation of assets and liabilities only when an active market exists and a disposal or transfer is a possible scenario for the entity"*.

As far as simplifications introduced, EFRAG believes that *"more simplifications in recognition and measurement should be considered inter alia, reinstating the amortisation of goodwill and other intangible assets, promulgating only one cost model and one revaluation model for non-financial assets, eliminating the reference to the name "fair value"...also, simplifications already made by the IASB need to be improved"*.¹⁵

We emphasised earlier that the view of the users of financial statements is definitely crucial for a successful implementation of the IFRS for SMEs. In this respect, the Certified Financial Analysts Institute (CFA Institute) has reservations regarding the whole concept of a separate set of Standards for SMEs. In its comment letter the CFA Institute says that *"The CFA Institute Centre does not support the IASB proposal to create a different set of reporting standards for SMEs. The views expressed by the lone dissenting board member in the alternative view section of the basis for conclusion align with our concepts on different standards: the proposed IFRS for SMEs would create non-comparable information"*.¹⁶

The CFA Institute continues the criticism when it says that *"the board would be better served to focus on the development of proper guidance for the full IFRS requirements ensuring that all companies operating in a particular area (e.g. derivatives or joint ventures) can apply them"*.

"The vast majority of accounting policy decisions of an SME are straightforward and extensive reference to IFRS will not be required and, when required, not burdensome".

The CFA Institute also questions the project because it believes that *"the vast majority of accounting policy decisions of an SME are straightforward and extensive reference to IFRS will not be required and, when required, not burdensome"*.

It believes that *"should this project succeed, a very broad group of potential capital providers, and importantly, those who advise capital providers of every type, credit rating agencies, would*

14: Source: Charlie McCreevy, European Commissioner for Internal Market and Services, excerpt from the speech given in Lisbon on 13 September 2007

15: Source: comment letter of the European Financial Reporting Advisory Group (EFRAG), 7 February 2008

16: Source: comment letter of CFA Institute, 16 October 2007

systematically be provided with sub-standard and less than transparent information, including information about activities that pose the greatest risks”.

Finally it concludes saying that *“the fundamental thesis regarding the development of an entirely separate and co-equal set of GAAP standards is severely flawed, and fails to consider the reason for the production of financial statements in the first place, to provide information that is useful to investors and other users of financial statements who base their investing and capital*

allocation decisions on the information. We urge the IASB to reconsider this course of action that could prove detrimental to investors and to financial markets in general”.

“We urge the IASB to reconsider this course of action that could prove detrimental to investors and to financial markets in general”.

With regard to fair value measurement, in another paper the CFA Institute explains that in its view *“fair value measurement is the information most relevant for financial decision making. As with company managers’ acquisition and divestiture decisions, investors, buy, sell, and hold decisions are based on fair values and changes in those values, not outdated historical costs”.*

¹⁷

It reinforces its view when it says that *“consequently, financial statements primarily based on outdated historical costs – measures that are removed by time and constantly changing markets from current conditions – are less useful for making such assessments”.*¹⁷

Again, it believes that *“as we have observed on a number of occasions, all financial decisions should be based upon fair values. Hence, fair value is the only relevant measurement attribute for items included in financial statements. All other bases, including historical cost, sacrifice usefulness and relevance to some other objective, such as convenience, or practicality, or a desire to obscure the underlying economics of a business”.*¹⁸

This view is consistent with a previous paper dated back to 1993, where it was emphasised that *“it is axiomatic that it is better to know what something is worth now than what it was worth at some moment in the past.Historic cost itself is in reality a historic market value, the amount of a past transaction engaged in by the firm. ... Historic cost data are never comparable on a firm-to-firm basis because the costs were incurred at different dates by different firms (or even within a single firm). There is no financial analyst who would not want to know the market value of individual assets and liabilities”.*¹⁹

The Hundred Group of Finance Directors in the UK takes the opposite view. They even call for a suspension of fair value accounting while the current financial crisis plays out. The chairman of the Hundred Group’s financial reporting committee Ken Lever said that *“market prices of sub-prime debt are low due to the fact that there is no-one willing to buy - in reality, much of this debt will never default. The prices imply a level of default that is unrealistic. The issue is that if you mark assets down, then the bank has a reduced capability to lend, which impacts liquidity*

17: Source: article of Rebecca T. McEnally, Director, Capital Markets Policy Group, CFA Centre for Financial Market Integrity, CFA Institute, 31 May 2005

18: Source: comment letter of the CFA Institute, 16 October 2007

19: Source: 1993 CFA Institute white paper, Financial Reporting in the 1990s and Beyond.

*which, in turn, creates further uncertainty leading to further reductions in market price and so it goes on”.*²⁰

Some other investors share the view of The Hundred Group of Finance Directors.

In general, national accounting bodies are not as negative as analysts and the EU. They welcome IFRS for SMEs, however, they have significant criticism regarding the simplifications introduced. In this respect they believe that many improvements are still needed.

The Accounting Standard Board of the UK (ASB) is, overall, more positive compared to many other European counterparts and is quite critical toward the negative position taken by the European Commission.

ASB says that *“the responses we had expressed a large degree of support for the ED. While most respondents did not see the proposed IFRS for SMEs as being suitable for small, and in particular micro, entities, there was a strong majority in favour of the standard being available for application by middle tier and larger companies.... On the evidence of the feedback the ASB has received, it is disappointing that the Commission appears to be taking such a negative stance on the IASB’s proposed IFRS for SMEs and seeming to rule out the possibility of Member States applying the standard”.*²¹

“Simplifications are not yet sufficient given the entities concerned and the typology of the stakeholders interested in the financial statements of SMEs”.

The Italian Organismo Italiano di Contabilita’ (OIC)²² feels that *“simplifications are not yet sufficient given the entities concerned and the typology of the stakeholders interested in the financial statements of SMEs”. ...If the aim is to establish simpler rules for entities that do not apply the full IFRS, reference to the full IFRS must be avoided, as otherwise, the preparer of the financial statement will have to know not only the IFRS for SMEs but also the full IFRS. In this way, it will avoid a situation where changes to the other IFRS automatically have knock-on effects on the principle for SMEs. Therefore, what is needed is a “stand alone” document”.*

“The current project is not simplified enough and would not be suitable for a large part of SMEs.”

OIC also criticises the still significant use of fair value. In fact it states that *“the extensive use of fair value for entities with just 50 employees does not appear to be in line with the Board’s aim of providing simplified rules for SMEs. Indeed, as EFRAG suggests, the use of fair value should be limited to a smaller number of items and only where there is an active market and the entity intend to dispose or transfer the asset. This would lessen the complexity of the criteria applied, so reducing the risk of errors or abuse, which more readily occur where the rules are more complex and where greater discretion is given to the preparers of financial statements”.*

20: Source: “Credit crunch sparks fair value revolt”, written by Penny Sukhraj, Accountancy Age, 03 Apr 2008

21: Source: comment letter of the Accounting Standards Board (ASB), 18 September 2007

22: Source: comment letter of the Organismo Italiano di Contabilita’ (OIC), 17 September 2007

The Mouvement des Entreprises de France (MEDEF) is also very critical as regards the need for more simplification. It says that *“the current project is not simplified enough and would not be suitable for a large part of SMEs.”*²³

MEDEF goes on and says that it *“shares EFRAG’s views on the differences existing in users’ needs and in the appreciation of cost – benefit analyses. It also considers that the standard should be redrafted to be more userfriendly, which is particularly important if it is tailored for small entities. That standard must be particularly pedagogic”*.

MEDEF also shares the concerns surrounding the fallback issue. It says that *“all cross references should be deleted and the final standard should be sufficiently independent of full IFRS to enable a satisfactory stability of the accounting standard, which is needed by SMEs”*.

ICAC, the Spanish Standard Setter shares most of the concerns of the EFRAG. In its comment letter it says that it *“agrees with EFRAG when it proposes to eliminate cross references but with some slight differences”* which are detailed in the following paragraphs of the letter.

ICAC²⁴ proposes some simplification with regards to the treatment of embedded derivatives, which in their view represents a major area of complexity. *“ICAC would be of the view that for SMEs, embedded derivatives and the host contract should not be asked to be accounted for and measured separately for SME, it would be a very helpful simplification. We also think that these instruments should be measured at fair value if it were available for the entity, otherwise cost could be accepted”*.

We urge the Board to continue with this project and to issue a final standard as soon as possible.

The South African Institute of Chartered Accountants (SAICA)²⁵ is *“fully supportive of this exposure draft... We urge the Board to continue with this project and to issue a final standard as soon as possible. Aligning IFRS for SMEs to IFRS with the same conceptual framework will assist SMEs in converting to IFRS when or if needed. Development of a global reporting standard for SMEs will also enhance global comparability between these entities.”*

“A wider application of an “undue cost or effort” principle to simplify accounting requirements further, is required”

However it also highlights that more simplification is needed and states that although supportive of this initiative, it believes *“that some significant simplifications are needed, before the final standard is issued, to further reduce the reporting burden on SMEs”*.

In particular it claims that *“a wider application of an “undue cost or effort” principle to simplify accounting requirements further, is required”*.

The comments from the South African Institute of Chartered Accountants are particularly interesting. In fact, in 2004, South Africa decided to adopt IFRS for all entities and this year it was the first country in the world to adopt the IASB’s proposed IFRS for SMEs.²⁶

23: Source: comment letter of the Mouvement des Entreprises de France (MEDEF), 24 September 2007

24: Source: comment letter of the Spanish Standard Setter (ICAC), 24 September 2007

25: Source: comment letter of the South African Institute of Chartered Accountants (SAICA), 10 October 2007

26: On 7 August 2007 the Accounting Practices Board (APB) approved the international Accounting Standards Board’s (IASB’s) exposure draft on IFRS for SMEs, without any change to the original text, as the South African

As Ignatius Sehoole²⁷ (Chairman of SAICA) explains this has come as a “*huge relief for SMEs in South Africa, compared with what they currently have to comply with. Since the adoption of IFRS every company has had to comply with the full standards. Not surprisingly, smaller companies have found those requirements burdensome and too complex for their needs*”. He says that “*the standard in its current form already offers SMEs real relief*”.

He continues by saying that “*an important factor was that by linking the SME standard in with international standards South Africa would provide greater security and comfort for foreign investors. ‘This is a global world’, Mr Sehoole said. ‘It is how things work. The international world, particularly when dealing with a developing country, is not interested in trying to find out what your local GAAP is about. Investors are much more relaxed and happier with IFRS. This is not just theory to us. Preparers tell us they have experienced a lower cost of capital as a result. To us it is a reality.*”

The American Institute of Certified Public Accountants (AICPA)²⁸ supports the IASB’s efforts to develop a final standard for SMEs.

In the U.S. typically non listed entities do not have statutory requirements to prepare external financial statements in accordance with GAAP. As the AICPA points out “*these entities do not have the option to prepare their financial statements in accordance with another basis of accounting (such as a tax basis), or under an approach that complies with GAAP but with certain exceptions.*”

These are the main reasons that the AICPA believes that IFRS for SMEs might be a viable and valuable alternative for US entities without public accountability.

National Accounting Standards Board of Russia (NASB)²⁹ supports the concept of a stand-alone document, with minimal cross-references to full IFRS. In this respect it believes that “*IFRS for SMEs should be the completely self-contained set of standards for SMEs and therefore all cross-references to full IFRS should be removed from them.*”

Statement of Generally Accepted Accounting Practice for Small and Medium-sized Entities (Statement of GAAP for SMEs).

Currently there are two types of companies as defined under the Companies Act of South Africa been:

- A company with a share capital; and
- A company without a share capital and having the liability of its members limited by the memorandum of association.

The APB has decided that the Statement of GAAP for entities will be applied as follows:

- The Statement of GAAP for SMEs may be applied by ‘limited interest companies’, as defined in the Corporate Laws Amendment Act, 2006, if they do not have public accountability as defined in Section 1 of the Statement of GAAP for SMEs.
- For entities other than companies where legal provisions or other regulations require compliance with a specific financial reporting framework (other than Statements of GAAP): such entities cannot apply the Statement of GAAP for SMEs even if they do not have public accountability as defined in Section 1 of the Statement of GAAP for SMEs.
- For entities other than companies whose financial reporting framework is not set out by legal provisions or other regulations: if such entities do not have public accountability, as defined in Section 1 of the Statement of GAAP for SMEs, they should assess whether it is appropriate to apply the Statement of GAAP for SMEs.

27: Source: source “South Africa – a view on adoption”, INSIGHT, The Journal of the IASB and the IASC Foundation, Q4, 2007

28: Source: comment letter of the American Institute of Certified Public Accountants (AICPA), 15 October 2007

29: Source: comment letter of the National Accounting Standards Board of Russia (NASB), 31 October 2007

The NASB also focuses its criticism on the “benefit over cost” principle and the use of fair value. It believes that *“simplifications proposed do not realise this principle in full. Indeed some concepts and requirements from full IFRS are extremely complex and expensive to apply and therefore may be paid back only when being applied by large companies to great volume of the same items or transactions. It’s true, in particular, for such concepts as ‘fair value’, ‘revalued value’ or ‘impairment of goodwill’. Therefore we suggest to simplify the fair value model for implementation by the SMEs.”*

“Therefore we suggest to simplify the fair value model for implementation by the SMEs.”

The Institute of Chartered Accountants in Australia (ICAA)³⁰ is also critical and not entirely happy with the simplifications proposed to be introduced, in particular with the extensive use of fair value. It states that it does not believe that *“sufficient consideration has been given in the proposal to the needs or wants of the key stakeholders of SMEs – such as users, preparers and auditors – in order to determine the appropriateness of recognition, measurement and disclosures. In particular we do not consider appropriate the use of fair value as a measurement principle in areas such as agriculture, financial instruments and share-based payments”*.

“We do not consider appropriate the use of fair value as a measurement principle in areas such as agriculture, financial instruments and share-based payments”.

On the other hand, the Australian Accounting Standard Board (AASB)³¹ has mixed views on the proposals, in particular they criticise the fact that *“the proposed IFRS is not a truly stand-alone document. The stand-alone nature of the document should be improved by including more of the appropriate treatment options in full IFRS instead of cross-referencing to full IFRS.”*

“Disclosures requirements are too onerous and should be reduced...”

In its view it is also *“not clear how the IFRS for SMEs might operate for the purpose of selecting accounting policies”*. It also thinks that there is a *“need for further simplification of the measurement and recognition requirements”* and, interestingly, they claim that *“the disclosures requirements are too onerous and should be reduced to those disclosures deemed necessary based on a consideration of user needs for SMEs at a general level and taking account of the financial statements as a whole”* and a separate section for disclosures rather than separate disclosures in each section is recommended.

The Dutch Accounting Standards Board (DASB)³² states that it is *“not opposed to a standard that would provide those with a constituent interest in financial reporting with what they need. However, it is those needs that should be the underlying premise for the standard. In our view, the approach take so far by IASB has ignored these”*.

30: Source: comment letter of the Institute of Chartered Accountants in Australia (ICAA), 3 September 2007

31: Source: comment letter of the Australian Accounting Standard Board (AASB), 28 November 2007

32: Source: comment letter of the Dutch Accounting Standards Board (DASB), 30 October 2007

As a result they conclude saying that: *“in our view, the current draft is not the one that was expected. Improving the present draft is not sufficient; a revised version would not meet the users’ needs. We are of the view that the standard should be re-written on the basis of the approach outlined before.”*

In particular the DASB believe that the need for a new global standard for companies that are not listed is significantly less. Such a standard may be particularly relevant in situations where no local standard is available.

The DASB believe that the approach taken by the IASB accepts as a premise that “one size fits all” and the DASB does not feel comfortable with that.

The DASB has raised a very important issue: the different needs between countries where local standards are not available, typically developing countries, and the countries that have a long established local reporting system which has proven over the years to adequately serve the business community. Clearly, the latest, might feel not entirely comfortable when they are asked to give up a well-known reporting system for a new and relatively unknown reporting system.

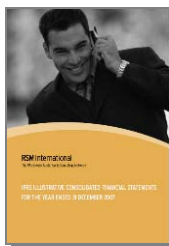
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