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Dear Mr Pacter

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

The Malta Institute of Accountants (MIA) welcomes the opportunity to provide its comments on the Discussion Paper (DP), *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* (SMEs). These comments have been approved by the Institute's Council and prepared by the Institute's Accounting Standards Committee, Small Company Reporting Committee and the SMP Advisory Committee.

MIA fully supports the International Accounting Standards Board ('the IASB') in its endeavours to develop high quality global accounting standards and to further international convergence of such standards. MIA, therefore, welcomes the IASB's initiative to develop financial reporting standards for small and medium-sized entities ('IASB Standards for SMEs').

As noted in the document, the DP examines issues relating to accounting standards for SMEs, identifies the Board's preliminary and tentative views on those issues, and raises questions about them. Our comments therefore reflect our views on the issues and questions raised in the DP and may be modified in the light of the Board's further considerations and revised position.

In Malta, all companies regulated by the Companies Act, 1995 ("the Act") have a statutory obligation to prepare financial statements that conform with International Financial Reporting Standards (IFRS). The great majority of those entities (over 95%) are SMEs – no matter how one might define "small" or "medium-sized". Practical compliance with IFRS has become increasingly burdensome for Maltese companies with the increasing 'sophistication' of IFRS, including in particular, the onset of IAS 39 on *Financial Instruments*. Tax base is based substantially on accounting profit, which is drifting further away from 'traditional' realised profit, as the trend towards unrealised fair value accounting increases.

The discussion currently being pursued by the Board is therefore all the more relevant in our local context.

Against this background, we strongly advocate simplified or different standards for the different types (based on size / economic significance) of SMEs, as, in our view, IFRSs are unnecessarily demanding for non-public entities, and some of the resulting information is not relevant for or used by the users of financial statements of SMEs, certainly for the micro-end of the spectrum.

This submission is organised as follows:

- | Executive Summary
- | Part 1 – Principal concerns on the IASB DP
- | Part 2 – Detailed responses to the specific questions raised in the DP

If you have any further questions about our views on these matters, do not hesitate to contact us.

Yours Sincerely

*[SIGNED]*

Tonio Zarb  
*President*

- | The DP acknowledges that the SME population which the intended IASB Standards for SMEs will address is not a homogenous one – para. 35 “ ... The Board sees no basis to focus only on the relatively larger non-publicly accountable entities and to state that IASB Standards for SMEs may not be suitable for very small entities”.
- | Enterprises within this population are differentiated in part by their size. At one end of the spectrum, one finds SMEs where segregation of ownership, management and financing are typically “Large and Medium-sized”. At the other end of the spectrum, “Small and Micro-sized” SMEs are generally associated with sole proprietors and owner-managed entities.
- | We maintain that a single set of SME standards will not be appropriate due to differing users and user needs of larger and smaller SMEs as well as cost burdens. The development of such standards should take into consideration a well-thought cost-benefit analysis.
- | We believe, therefore, that two different sets of standards are required for the different types of SMEs. Furthermore, we disagree with the Board's “rebuttable presumption of no recognition and measurement modifications”. In the absence of such modifications, it is likely that the IASB Standards for SMEs will only marginally reduce the burden of full IFRS accounting.
- | A “fair value balance sheet approach” for the larger SMEs with principally disclosure and some measurement relaxations from full IFRS, but no recognition simplifications, should form the basis of the development of standards for such enterprises.
- | On the other hand, a “historic cost profit and loss account approach” for smaller enterprises with reduced disclosure requirements and additional measurement and recognition relaxations (to be justified by identified user needs) would be more suitable.
- | It would be strategically unadvisable for the IASB, as the internationally recognised global accounting standard setter, to ignore the smaller SME population and leave this area open to others to regulate their financial reporting needs. IASBs involvement would also facilitate / ensure convergence to full IFRS as enterprises grow in size or choose to switch to full IFRS.

- 1 The SME Financial Reporting debate will be much enhanced if appropriate challenge is made to the fundamental assumption subsuming the IASB's DP: that the accounting model that is being tailored to user needs is one comprising a single enormous grouping of business enterprises that is referred to as 'SME'. There is little, if any, similarity between the typical users and user needs of micro-entities at the lower end of the SME spectrum and the larger enterprises at the upper end thereof. One extreme would comprise sole proprietors and small owner-managed enterprises; the other would comprise enterprises where segregation of ownership, management and financing would have become practical operational necessities in order to sustain the larger level of underlying business transactions.
- 2 This basic factual distinction in the entrepreneurial fibre of any economy does not make any one type of entrepreneurial reality any 'better' than the other. All contributory parts of the wealth generating economic fabric have a full and important part to play in the development of market economies. Indeed, the micro-end of the SME spectrum generally represents by far the most numerically significant part of the economic wealth generating units in any economy.
- 3 The sheer enormity of the SME population is such as to present potentially insurmountable challenges in the development of a single universal accounting model that would be able to meet the typical user and user needs of all its constituent economic sub-groupings.
- 4 It would not be considered strategically advisable for the IASB to ignore the smaller end of the SME spectrum in its standard setting work. This would unnecessarily undermine the hard-earned and justified internationally held view of the IASB as being the global authority on accounting matters. Furthermore, direct involvement by the IASB in this area will help to facilitate and ensure the structured transition of applicable standards towards full IFRS as enterprises grow into larger and publicly accountable enterprises.
- 5 Accordingly, it is considered that a strategic critical success factor in the IASB's work on developing accounting standards for SMEs is to recognise and acknowledge the economic reality that larger and smaller SMEs have fundamentally different users and user needs which justifiably would require different accounting solutions in order to ensure relevance of their financial reporting models. Non-universality will not result in a set of 'inferior' standards, but on the contrary will ensure the development of global world-class accounting standards that are most appropriate to the particular needs of the relevant users and will ensure the achievement of the Board's constitutional objectives.
- 6 Persistently setting pre-conditions on the quasi-impossibility of modifying recognition and measurement requirements indicates significant and worrying bias in the IASB's standard setting process. Furthermore, it is arguable that the development of appropriate standards for SMEs, particularly for the smaller micro-end thereof, might in practice be difficult or unfair to expect other than from a development group which is predominantly inclusive of standard setters with day to day working experience with micro enterprises.
- 7 It is impressive to note the near-total disregard of the overwhelming body of response to the IASB's survey in preparation for the World Accounting Standard Setters Meeting in London in September 2003, comprising the European Financial Reporting Advisory Group (EFRAG) and standard-setters from 29 countries. Of these 30 respondents, 24 responded, *inter-alia* that the IASB should provide recognition and measurement differences for SMEs. Reasons given included that existing IFRSs are aimed primarily at information needs of public capital markets, that SMEs generally lack accounting sophistication and expertise, that there are different user needs for SMEs and that their financial statements are prepared primarily for owner-managers and bankers.

- 8 In paragraphs 36 and 37 of the DP, the Board promulgates a universal approach to the development of appropriate SME accounting standards. Paragraph 36 states that 'the Board sees no basis to focus only on the relatively larger non-publicly accountable entities and to state that IASB Standards for SMEs may not be suitable for very small entities'. Paragraph 37 mentions the view that the 'Board should develop standards for SMEs that are aimed only at the relatively smaller entities, rather than all sizes of non-publicly accountable entities'. It is unclear why a universal approach is necessary or advisable. On the contrary, preliminary indications would suggest that perhaps the more appropriate way forward would be to develop two sets of standards for SMEs – one contemplating larger SMEs where perhaps relaxation would be principally of disclosure and presentation requirements, and the other contemplating smaller SMEs where perhaps relaxation of recognition and measurement principles may additionally be justifiable.
- 9 Paragraph 10 of the Framework states that 'While all the information needs of *[these]* users cannot be met by financial statements, there are needs which are common to all users. As investors are providers of risk capital to the enterprise, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy'. It is submitted that the principal characteristics of the investor / shareholder group are fundamentally different in the case of micro owner-managed enterprises and in larger SMEs, and accordingly the development of accounting standards on the basis of the user needs of investors in the larger enterprises, as has been the case so far, creates unnecessary burdens when imposed universally on all entities, including smaller SMEs.
- 10 The tables below provide a review of the principal users and user needs of the financial statements of publicly accountable, larger and micro enterprises.

Principal Users of Financial Statements			
<i>Relevance of Financial Statements</i>	<i>Publicly Accountable</i>	<i>"Large and Medium-sized" SMEs</i>	<i>"Small and Micro-sized" SMEs</i>
Investors	Very relevant	Very relevant	Very relevant
Employees	Very relevant	Relevant	Not relevant
Lenders	Very relevant	Very relevant	Very relevant
Suppliers and other trade creditors	Very relevant	Very relevant	Relevant
Customers	Very relevant	Relevant	Not relevant
Governments and their agencies	Very relevant	Very relevant	Very relevant
Public	Very relevant	Not relevant	Not relevant

Predominant User Needs			
<i>Predominant User Need</i>	<i>Publicly Accountable</i>	<i>“Large and Medium-sized” SMEs</i>	<i>“Small and Micro-sized” SMEs</i>
Investors	Fair value of enterprise for buy / sell / hold decisions		Stewardship accounting and determination of realised distributable profit;  When necessary, share valuation report commissioned from an external expert
Employees	Realised profit on ordinary activities; liquidity position; going concern		Not relevant
Lenders	Realised profit on ordinary activities; value of enterprise, solvency and other information from special purpose reports		Realised profit on ordinary activities; value of enterprise, solvency and other information from special purpose reports
Suppliers and other trade creditors	Realised profit on ordinary activities; liquidity position; going concern		Realised profit on ordinary activities; liquidity position; going concern
Customers	Going concern		Not relevant
Governments and their agencies	Various including: turnover, employment and investment data, realised profit on ordinary activities and going concern		Various but principally determination of realised profits for direct taxation purposes
Public	Various including: realised profit on ordinary activities; liquidity position; going concern		Not relevant

- 11 While it is acknowledged that the specific contents of various parts of the tables above are possibly subjective and open to debate, it is considered that there should be general agreement that the application of a fair-value / balance sheet accounting model, which would be most appropriate for publicly accountable enterprises, probably becomes increasingly irrelevant as one moves down the SME spectrum towards micro-enterprises where it is probable that a historical-cost / profit and loss approach would be more appropriate, and where defining profit as the difference between two fair-valued balance sheets might not be relevant to the needs of users of those financial statements, where the determination of distributable realised profits would probably be the primary objective.
- 12 Accordingly it is considered that the IASB's development of accounting standards for SMEs should acknowledge and recognise that the SME population consists of large and micro enterprises with distinct users and user needs that require separate treatment. While relaxation of disclosure, presentation and measurement standards from full IFRS (i.e. a 'Top-Down' approach) might be justified in the case of larger SMEs, a bespoke 'Bottom-Up' approach potentially resulting additionally in recognition simplifications may be more appropriate for the smaller SMEs.

The comments below follow the order in which the preliminary views are set out in the DP and are numbered accordingly.



## **Whether the IASB should develop Standards for SMEs**

### **Issue 1**

#### **Should the IASB develop special financial reporting standards for SMEs?**

##### **Preliminary view 1.1 – Full IFRSs are suitable for all entities**

- 4 The objective of financial statements as set out in the IASB Framework for the Preparation and Presentation of Financial Statements is appropriate for SMEs as well as for entities required to follow full IFRSs. Therefore full IFRSs should be regarded as suitable for all entities.

*We disagree that full IFRS should be regarded as suitable for all entities, for the reasons set out in Part 1.*

##### **Preliminary view 1.2 – The Board will develop standards for SMEs**

- 4 The Board will develop a set of financial reporting standards that is suitable only for those entities that do not have public accountability ‘IASB Standards for SMEs’. Such standards would not be intended for use by publicly accountable entities, including those whose securities have been listed for trading in a public securities market, even if national law or regulation were to permit this.

*Disagree with the development of a single universal set of accounting standards for all SMEs without distinction between larger and micro SMEs, for the reasons set out in Part 1.*

##### **Preliminary view 1.3 – Disclose the basis of presentation**

- 4 If an entity follows IASB Standards for SMEs, the basis of presentation note and the auditor’s report should make that clear. IASB Standards for SMEs should not be used by publicly listed entities (or any other entities not specifically intended by the Board) even if national law or regulation were to permit this.

*Agreed.*

## Objectives of IASB Standards for SMEs

### Issue 2

#### What should be the objectives of a set of financial reporting standards for SMEs?

##### Preliminary view 2

16 Financial reporting standards for SMEs should:

- (a) provide high quality, understandable and enforceable accounting standards suitable for SMEs globally;
- (b) focus on meeting the needs of users of SME financial statements;
- (c) be based on the same conceptual framework as IFRSs;
- (d) reduce the financial reporting burden on SMEs that want to use global standards;
- (e) allow easy transition to full IFRS for those SMEs that become publicly accountable or choose to switch to full IFRSs.

*For the reasons set out in Part 1, focusing on meeting the needs of users of SME financial statements may be potentially inconsistent with maintaining the same conceptual framework as IFRSs; i.e. Fair-value / Balance Sheet approach vs. Historical-cost / Profit and Loss account for smaller SMEs.*

17 ... Objectives (c) and (e) reflect the Board's intention that IASB Standards for SMEs should be a modified version of full IFRSs rather than a body of standards developed independently of full IFRSs.

*Disagree.*

*The development of appropriate Standards, particularly for smaller SMEs, should be driven by user needs and not by pre-conditionally requiring convergence with full IFRS, for the reasons set out in Part 1.*

## **Definition of SME**

### **Issue 3**

#### **For which entities would IASB Standards for SMEs be intended?**

- 25 The Board also examined a separate but related question: whether IASB Standards for SMEs should be intended only for some but not all SMEs – for instance, only for ‘relatively large’ SMEs and not for ‘very small’ ones (or vice versa). However, pursuing this approach would require the Board to specify size criteria that would apply globally and for a period of years, and this is very difficult if not impossible.

*Disagree.*

*Separate standards for larger and smaller SMEs are to be developed, for the reasons set out in Part 1. Any quantitative criteria are to be established nationally.*

#### **Preliminary view 3.1 – No size test**

- 26 The Board should describe the characteristics of the entities for which IASB Standards for SMEs are intended. Those characteristics should not prescribe quantitative ‘size tests’. National jurisdictions should determine whether all entities that meet those characteristics, or only some, should be required or permitted to use IASB Standards for SMEs.

*Agreed.*

*Any quantitative size tests to be established nationally.*

#### **Preliminary view 3.2 – Public accountability principle**

- 28 Public accountability is the overriding characteristic that distinguishes SMEs from other entities. Full IFRSs, and not IASB Standards for SMEs, are appropriate for an entity that has public accountability. An entity has public accountability if:

- (a) there is a high degree of outside interest in the entity from non-management investors or other stakeholders, and those stakeholders

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depend primarily on external financial reporting as their means of obtaining financial information about the entity; or

- (b) the entity has an essential public service responsibility because of the nature of its operations.

*Agreed as regards entities requiring compliance with full IFRS.*

*Disagree to the extent that non-publicly accountable entities can be considered as a single homogenous population for financial reporting purposes, for the reasons set out in Part 1.*

- 30 By having filed its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market, an entity automatically becomes publicly accountable. However, an entity does not become publicly accountable simply because, in its home jurisdiction, it is required to submit its financial statements to a central registry maintained by a government agency and open to public inspection.

*Agreed.*

### Preliminary view 3.3 – Presumptive indicators of public accountability

- 31 A business entity would be regarded as having public accountability, and therefore should follow full IFRSs, if it meets any of the following criteria:
- (a) it has filed, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market;
  - (b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker / dealer, pension fund, mutual fund or investment banking entity;
  - (c) it is a public utility or similar entity that provides an essential public service; or
  - (d) it is economically significant in its home country on the basis of criteria such as total assets, total income, number of employees, degree of market dominance, and nature and extent of external borrowings.
- 32 (d) ... Guidance on the specific criteria for assessing economic significance in an individual national jurisdiction would be left to the regulatory authorities or standard-setters in that jurisdiction – consistently with the principles in IASB Standards for SMEs.

*Agreed.*

#### Preliminary view 3.4 – Required assent of all owners

- 33 An entity that does not satisfy any of the presumptive indicators of public accountability would nevertheless be regarded as having public accountability unless it has informed all of its owners, including those not otherwise entitled to vote, that it intends to prepare its financial statements on the basis of IASB Standards for SMEs rather than on the basis of IFRSs, and none of those owners objects to using IASB Standards for SMEs.

*Would not oppose.*

*But disagreement, or non-response, of even one owner should not make the entity publicly accountable. In view of the cost and effort in preparing full IFRS financial statements and the fact that preliminary views 3.2 and 3.3 already adequately identify publicly accountable enterprises, the preferred option would be for a minimum percentage of objecting owners to be required (say 5% as in Australia).*

#### Preliminary view 3.5 – Scope: all entities that do not have public accountability

- 35 The Board intends to include all entities that do not have public accountability as potential adopters of IASB Standards for SMEs.
- 36 The Board sees no basis to focus only on the relatively larger non-publicly accountable entities and to state that IASB Standards for SMEs may not be suitable for very small entities. In the Board's judgement, that is inconsistent with its conclusion in preliminary view 1.1 that full IFRSs are suitable for all entities. If full IFRSs are not unsuitable for very small entities, then surely IASB Standards for SMEs are not unsuitable. Whether to require or permit very small entities to use IASB Standards for SMEs is a matter for each national jurisdiction to decide. The Board determines which entities are eligible to use IASB Standards for SMEs. Then each national jurisdiction must decide whether to permit or require IASB Standards for SMEs to be adopted by all, some or for that matter none, of the entities that, based on the IASB's definition of an SME, are eligible to use those standards.
- 37 Some believe that the Board should develop standards for SMEs that are aimed only at the relatively smaller entities, rather than all sizes of non-publicly accountable entities. Those who advocate this approach point out that non-publicly accountable entities can include some of the largest private business entities in the world, and also millions of tiny entities. In their judgement, the

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same financial reporting standards are not suitable for all non-publicly accountable entities because of differences in user needs as well as cost burdens. They encourage the Board to focus its standards for SMEs on small entities. However, criterion (d) in preliminary view 3.3 – that an entity is regarded as publicly accountable, and therefore not an SME, if it is economically significant in its home country – will exclude most large unlisted entities from the target user group for IASB Standards for SMEs.

*Disagree.*

*The Board should develop appropriate separate standards for the larger SMEs and for the smaller SMEs. The SME population cannot be assumed to be a homogenous population for financial reporting purposes, for the reasons set out in Part 1.*

### Preliminary view 3.6 – Subsidiaries, joint ventures and associates

- 38 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 the parent, venturer or investor, it should comply with full IFRSs, not IASB Standards for SMEs, in its separate financial statements.

*Preferred view would be for individual accounts to follow specific applicable SME accounting standards since these standards should appropriately reflect the relevant user needs.*

## **Mandatory Fallback**

### **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?**

##### **Preliminary view 4 – Mandatory fallback to IFRSs**

- 46 If IASB Standards for SMEs do not address a particular accounting recognition or measurement issue that is addressed in an IFRS, the entity would be required to look to that IFRS to resolve that particular issue only. The entity would continue to use IASB Standards for SMEs for the remainder of its financial reporting. Each IASB Standard for SMEs should explicitly mention the required fallback to IFRSs.
- 47 The Board favours this approach for the reasons of comparability and consistency with ... the IASB *Framework* ... .

*Agreed subject to the following:*

- ‡ *The objective is to produce accounting standards that are relevant and useful to users of SME financial statements. Producing a condensed version of IFRS is not the goal.*
- ‡ *A careful balance needs to be reached between simplification and comprehensiveness when determining those matters to be dealt with in the IASB Standards for SMEs. If too many accounting matters are perceived to relate to transactions not commonly undertaken by SMEs and are thus excluded from the Standard in the interest of simplification, then the risk is that compliance with full IFRS would effectively have been perpetuated. In such a scenario, once an SME undertakes any of the excluded classes of transactions, which can reasonably be assumed to represent those with the more challenging accounting treatments, then full compliance with the relevant IFRS would be required. Clearly the effectiveness of such an approach in achieving standards which are relevant and useful to users of SME financial statements would be questionable.*
- ‡ *Ideally all areas addressed by IFRSs are considered and included appropriately in the IASB Standard for SMEs so that the Standard represents a stand-alone document and the question of reference to IFRS does not arise. Reference to the Framework would be made in the case of matters not covered by the IASB Standard for SMEs, in the same way as is presently the case with full IFRS.*

## **Optional Reversion to an IFRS by an Entity Using IASB Standards for SMEs**

### **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 Standards for SMEs?**

##### **Preliminary view 5 – Optional reversion to an IFRS**

- 52 If an IASB Standard for SMEs provides an exemption or simplification from a recognition or measurement requirement in the related IFRS, an entity that uses IASB Standards for SMEs would not be prohibited from applying the related IFRS in its entirety, while continuing to use IASB Standards for SMEs. Optional reversion would not be permitted for only some, but not all, principles in the related IFRS.
- 56 Some would prohibit an SME from following a treatment in an IFRS that differs from the treatment in the related IASB Standards for SMEs for reasons of inter-entity comparability. They contend that the financial statements of such an SME will not be comparable either with those of other SMEs or with those of entities that follow full IFRSs. The Board acknowledges the potential for reduced inter-entity comparability but believes that it is more than offset by the benefits of entities following full IFRSs.
- 57 In preliminary view 5, the Board has tentatively concluded that if an SME that otherwise is using IASB Standards for SMEs elects to revert to the recognition and measurement requirements in an IFRS, it must follow all of the requirements of that IFRS. In other words, reversion to the IFRS must be on a standard-by-standard basis. The entity would not be permitted to adopt some recognition and measurement principles in the IFRS selectively while using other recognition and measurement principles in the related IASB Standard for SMEs. The recognition and measurement principles in each IFRS are interrelated and are adopted by the Board as a package, and they should be applied as such.
- 58 In some cases bankers or other users of an SMEs financial statements may request or insist that the SME follow a particular IFRS. Preliminary view 5 is intended to prevent such a requirement from forcing an SME to use full IFRSs. It is for this reason that the Board rejected the alternative of requiring an entity to choose only either the complete set of IFRSs or the complete set of IASB Standards for SMEs.
- 59 Some support a middle ground between reverting to an IFRS in its entirety and allowing an entity to revert on a principle-by-principle basis. They question whether an entity's decision to use a treatment in an IFRS should trigger a



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requirement to use those recognition and measurement standards in the IFRS that are not interrelated with the one that the entity wishes to use. They cite, as an example, an entity wishing to amortise premium or discount using the effective interest rate method in IAS39, if the principle in the IASB Standard for SMEs were to be straight-line. Under preliminary view 5, using the effective interest method would require the entity to use all of IAS39. Therefore, even if the SME version of IAS39 were to include, for example, some simplifications relating to hedge accounting, those simplifications would not be available to the SME using the effective interest method. The Board is open to considering a middle ground between allowing reversion to an IFRS only in its entirety and allowing reversion on an unrestricted principle-by-principle basis ... .

*The preferred option is to disallow optional reversion to an IFRS.*

*If the relevant user needs for SME financial reports have been appropriately identified and tackled in the formulation of the IASB Standards for SMEs, then allowing optional reversion to full IFRS can only undermine the work carried out and imply that the prescribed standards have not been properly determined from user needs. Comparability of results will be totally lost if a 'pick and choose' approach is permitted.*

*The special circumstances arising on those particular SMEs that happen to have compliance with certain IFRSs imposed on them by bankers and lenders (as noted in paragraph 58 of the DP) should not result in a chaotic framework for the vastly larger remainder of the SME population, and should be addressed through the preparation of special purpose financial statements tailored to their lenders' specifications.*

*Without prejudice to the above, if however the prevailing view is to permit optional reversion to IFRS then clearly the 'middle ground' approach (reversion on a principle-by-principle basis, rather than reversion to an IFRS in its entirety) is to be followed.*

## Starting Point for developing IASB Standards for SMEs

### Issue 6

#### **How should the Board approach the development of IASB Standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?**

61 The alternatives considered were:

- (a) IASB Standards for SMEs should be developed by starting with full IFRSs and modifying them as appropriate.
- (b) IASB Standards for SMEs should be developed as a separate body of standards independent of full IFRSs.

Preliminary view 6 – IFRSs are the starting point for developing SME standards

62 Development of IASB Standards for SMEs should start by extracting the fundamental concepts from the IASB Framework and the principles and related mandatory guidance from IFRSs (including Interpretations).

*Disagree.*

*The SME population is not and cannot be assumed to represent a homogenous population for financial reporting purposes. Typical users and user needs are different and relevant and useful accounting standards for SMEs require this to be acknowledged and appropriately handled.*

*Alternative a (i.e. IASB Standards for SMEs should be developed by starting with full IFRSs and modifying them as appropriate) should be used for the 'larger' SMEs.*

*Alternative b (i.e. IASB Standards for SMEs should be developed as a separate body of standards independent of full IFRSs) should be used for the 'smaller' SMEs.*

## **Appropriate Bases for Modifying Concepts and Principles for SMEs**

### **Issue 7**

#### **If IASB Standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?**

- 65 In preliminary view 6, the Board tentatively concluded that the starting point for developing IASB Standards for SMEs should be the Framework and IFRSs. The nature of any modifications of the Framework and IFRSs must be guided by the objectives of the IASB's standards for SMEs that the Board has tentatively concluded in preliminary view 2, namely (a) to meet the needs of users of SME financial statements and (b) to reduce the financial reporting burden on SMEs that wish to use global standards. Assessing user needs and assessing costs and benefits are necessary considerations for all standards developed by the IASB. Thus issue 6 does not involve 'alternative' solutions but, rather, consideration of how to balance the trade-offs inherent in meeting user needs and reducing the burden on preparers.

#### **Preliminary view 7.1 – Justification for modifications**

- 66 Any modifications to the concepts or principles in IFRSs must be based on the identified needs of users of SME financial statements or cost-benefit analyses.

*Agreed, although disagree with the assumption that all SME population is a homogenous population for financial reporting purposes for the reasons set out in Part 1.*

#### **Preliminary view 7.2 – Likelihood of disclosure and presentation modifications**

- 67 It is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost-benefit analyses. The disclosure modifications could increase or decrease the level of disclosure relative to full IFRSs.

*Agreed, though it is not considered likely that further disclosures will be required.*

### Preliminary view 7.3 – Rebuttable presumption of no recognition and measurement modifications

- 68 There would be a rebuttable presumption that no modifications would be made to the recognition and measurement principles in IFRSs. Such modifications can be justified only on the basis of user needs and cost-benefit analyses.
- 76 In deciding which modifications to make, the Board will also be guided by the costs and other burdens that particular requirements in IFRSs impose on SMEs. For example, there would be minimal benefit – but possibly a substantial cost – for an SME to provide information that users of its financial statements do not use. In that regard, some contend that once an item has been accounted for in accordance with the recognition and measurement standards in an IFRS, the additional cost of disclosure is usually not significant. Therefore, in their view, to achieve a significant reduction in the burden for preparers of financial statements of SMEs it will be necessary to ‘relax’ some recognition and measurement requirements in IFRSs. Others support a relatively sizeable number of differences for such SMEs – in recognition and measurement standards as well as in disclosure and presentation standards. The Board’s preliminary view is that users of financial statements that bear the title of ‘International Financial Reporting Standards for SMEs’ need and expect a level of financial reporting that is based on full IFRSs and includes only a relatively limited number of modifications to full IFRSs.
- 83 The principles in the Framework for recognising assets and liabilities include an ability to make reliable measurements of cost or value (for assets) or settlement amount (for liabilities). Because of both the nature of the business environment of some SMEs and constraints on their resources, when measuring some assets and liabilities (and related income and expenses) the cost to obtain the same degree of measurement reliability as would be required of an entity applying full IFRSs might not be justified in some circumstances for an SME. Although preliminary view 7.3 establishes a rebuttable presumption of no recognition or measurement differences, the presumption might be more easily rebuttable in the case of measurement principles than in the case of recognition principles. ...
- 84 Some national financial reporting systems provide recognition and measurement differences for SMEs. In most cases, the differences relate to matters of:
- (a) measurement simplification rather than recognition – for example, measurement of some assets at cost rather than at fair value, simplified amortisation calculations and simplified calculations of employee benefit obligations; and
  - (b) substitution of some note specific disclosures for balance sheet recognition – for example in the areas of income taxes and leases.

*Disagree.*

*User needs should be the driving factor and accordingly in the case of larger SMEs some disclosure, presentation and measurement relaxations from full IFRS, and probably without recognition simplifications, might be appropriate; while in the case of smaller SMEs measurement and even recognition simplifications might be justifiable. Please refer to Part 1.*

## **Format for Publishing IASB Standards for SMEs**

### **Issue 8**

#### **In what format should IASB Standards for SMEs be published?**

##### **Preliminary view 8.1 – Separate volume**

- 88 IASB Standards for SMEs should be published in a separate printed volume. The Board may also use other means of publication, such as Web publishing.

*Agreed.*

##### **Preliminary view 8.2 – Organised by IAS / IFRS (and Interpretation) number**

- 89 IASB Standards for SMEs should:
- (a) follow the IAS / IFRS (and Interpretation) numbering system – ie. SME- IAS 1, SME – IAS 2 etc and SME – IFRS 1, SME – IFRS 2 etc; and
  - (b) not be recognised by topic, such as integrated in a balance sheet – income statement line item sequence like the UK FRSSE.

*It is considered that a topical organisation of the IASB Standards for SMEs in the form of a reference manual would be of greater assistance to users since this is likely to reflect the way in which the Standards would be referred to in practice.*

##### **Preliminary view 8.3 – Foreword material in each Standard**

- 91 Each IASB Standard for SMEs should include a statement of its objective and a summary.

*Agreed.*