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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Discussion Paper - Preliminary Views on Accounting for Standards for Small and Medium-sized Entities

Dear Sir David,

Deloitte Touche Tohmatsu is pleased to comment on the International Accounting Standards Board's (IASB's) Discussion Paper *Preliminary Views on Accounting for Standards for Small and Medium-sized Entities* (the Paper).

We believe that this consultation is timely as it will allow the IASB to consider the comments and to amend, as appropriate, its preliminary views before proceeding to an exposure draft stage. We have serious reservations about certain aspects of this project, which we detail in the appendix to this letter. In our view, if the IASB were to continue the project based on its preliminary views, then the resulting standards for small and medium-sized entities (SMEs) would be of limited practical use, would not address the needs of SMEs and would not reduce significantly the number of separate accounting regimes for SMEs around the world. We believe that this SME project is very important politically for the IASB's standing around the world. The Board's consultations with national standard-setters and its own Standards Advisory Council have demonstrated the need for this project and the priority attached to it.

We acknowledge the current time and work pressures on the Board. We suggest that the IASB or the International Accounting Standards Committee Foundation (IASCF) considers establishing a committee focused on SME accounting. Responsibility for developing the Standards for SMEs would be deputed to this committee, with final approval by the IASB, in the same way as responsibility for developing Interpretations rests with IFRIC subject to final Board approval. This project needs adequate attention to ensure the correct foundations are in place.

In summary, we recommend that the IASB:

- develops a standard suitable for SMEs. We encourage the Board to follow the approach, adopted first by the UK Accounting Standards Board and subsequently by other standard-setters, to create a concise standard, an International Financial Reporting Standard for SMEs;
- agrees some size criteria for SMEs which it uses purely in its own workings to ensure that the SME standards are for small and medium sized entities and are not suitable for larger entities whose shares or debt may not be traded. Decisions on final application should be made by the national regulators and standard-setters; and
- considers at some stage providing further disclosure exemptions in the full IFRSs for those entities whose shares or debt instruments are not publicly traded. This could be achieved relatively simply by adding paragraphs to those IASs or IFRSs affected, building on the current exemptions in IAS 14, 27 and 33.

We appreciate the opportunity to provide our comments. If you have any questions on our response, please contact Ken Wild +44 207 007 0907.

Sincerely,



Deloitte Touche Tohmatsu

Appendix

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

We believe that full IFRSs are suitable for all entities that are preparing financial statements for which the objective is to provide information about the financial position, performance and change in financial position of an entity that is useful to a wide range of users in making economic decisions. If the objective of the financial statements is not to appeal to such a wide range of users who are making economic decisions, then full IFRSs may not necessarily be appropriate.

Paragraph 14 of the IASB's Framework sets out a secondary objective for financial statements, namely to show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Our experience is that SMEs prepare financial statements so that users may have an annual check on management's stewardship of the business. For those users who are shareholders, their holdings rarely change hands and are generally passed on to family members or longer serving employees at times of retirement or death. They are not making routinely decisions whether to buy, sell or hold shares in the entity.

For many other types of users, such as banks, they have the economic power to demand information from the entity on a more timely basis. For example, banks may demand cash flow statements on a quarterly basis or may secure their borrowings against the personal assets of the owner managers. In addition, banks typically use the financial statements as an annual check that what they understand has been happening in the business accords with the picture presented in those financial statements. Therefore, the stewardship objective is of prime importance in SMEs. Thus, accounting standards for SMEs should be designed to meet that objective. The difficulty is in practice identifying the line between those entities in which utility regarding economic decisions takes precedence over stewardship and vice versa. This issue is discussed further in our response to Question 3.

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

We believe it is very important that the Board develops a set of financial reporting standards for SMEs as soon as possible. Many jurisdictions around the world currently have differential reporting regimes. Full IFRSs, with their focus on providing information for making economic decisions, may not be suitable for SMEs simply because they are not designed to meet the needs of this particular sector. In our experience, users of SMEs' financial statements are looking for standards which result in disclosures that are likely to be meaningful and comprehensive to them. Standards that provide the least cumbersome method of achieving the accounting treatment and/or disclosure that is not complex are sought. Standards are wanted that provide guidance that is widely relevant to the transactions of SMEs and that are written in terms that can be understood by such businesses.

If the IASB were not to take on the task of producing standards for SMEs, then it will be necessary for many national jurisdictions to create their own rules for SMEs or, potentially, perpetuate their existing practices. We believe the role of the IASB is to develop high quality global accounting standards that require transparent and comparable information. In our view, the features of the SME sector demand a separate accounting regime but it is very important from a global point of view and to support full IFRSs that the IASB should develop such a regime and make it available to national jurisdictions.

Question 1c
Do you agree that IASB Standards for SMEs should not be used by publicly listed entities (or any other entities not specifically intended by the Board), even if national law or regulation were to permit this? Do you also agree that if the IASB Standards for SMEs are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs? If not, why not?

We fully support the Board's preliminary view 1.3 that if an entity follows IASB Standards for SMEs, the basis of presentation note should make that clear.

We also share the view set out in paragraph 13 of the Paper that publicly listed entities and any other entities for whom the IASB Standards for SMEs are not intended should not be permitted by their national law or regulation to use such standards. However, as the Board recognises, decisions on which entities use which IASB Standards rests with national regulatory authorities and standard setters.

If IASB Standards for SMEs are used by non-SMEs then their financial statements should make this fact clear. Furthermore, while it is not a matter for the IASB, we would encourage the IAASB to consider issuing guidance advising auditors to qualify their reports in such cases.

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

The purpose of IASB Standards for SMEs is to produce financial statements which meet the objectives of financial reporting in that sector. As indicated in our responses to Questions 1a and 1b, IASB Standards for SMEs should:

(a) focus on meeting the needs of users of SME financial statements; and

(b) provide high quality, understandable and enforceable accounting standards suitable for SMEs globally.

A by-product of this process is likely to be a reduction in the financial reporting burden on SMEs that wish to use these global standards as opposed to full IFRSs. Objective (e), namely allowing easy transition to full IFRSs for those SMEs that either become publicly accountable or choose to switch to full IFRSs, should not be of primary importance, although it is a desirable outcome. Our experience is that only a very modest number of

SMEs seek to grow into larger entities that achieve public listings. Furthermore, those who see themselves on such a path can always elect to use full IFRSs on the basis that those financial statements are likely to be of interest to a wide range of users in making economic decisions in the run up to a public offering. If the IASB were to abdicate responsibility for setting accounting standards for SMEs to a body outwith the IASCF family, we believe that the risk of divergence between the two accounting regimes would increase significantly and that achieving objective (e) would be more important.

Preliminary view 2 contains a further objective that the reporting standards for SMEs should be based on the same conceptual framework as full IFRSs. We do not support the promulgation of a proliferation of conceptual frameworks. However, we believe that some degree of tailoring is needed for SMEs in the accounting framework so that the appropriate financial statement objectives are met. In other words, not all of the statements in the present Framework fit SMEs. Rather than creating another framework document for SMEs, the same conceptual framework should be used with a few of the paragraphs expanded as necessary to deal with SME issues.

Question 3a
Do you agree that the Board should describe the characteristics of the entities for which it intends the standards but that those characteristics should not prescribe quantitative 'size tests'? If not, why not, and how would an appropriate size test be developed?

We agree that national jurisdictions ultimately should determine whether entities that meet the IASB characteristics for SMEs should be required or permitted to use the IASB Standards for SMEs. We do not believe that it is possible to have a quantified size test capable of uniform application in all countries. However, we believe the Board should set some upper limits beyond which it would consider that its Standards for SMEs would be inappropriate. The project to date appears to have been plagued by a lack of a common understanding of the type of entity for which these standards are designed. The overriding characteristic is that the entity would not have public accountability. As a consequence, extremely large entities in large countries, while not individually economically significant in the country, could be eligible to use the Standards for SMEs. Since these relatively large entities can be caught then the standards being developed are unlikely to be appropriate for SMEs.

We believe the Board should adopt some sort of quantitative threshold. For example, the Board would envisage that anything that does not qualify as an SME under European legislation would be unsuitable for using the Standards for SMEs. Using the European definitions has the advantage of providing some guidance for 25 countries. Of course, those countries could use different thresholds depending on their own economic circumstances.

Question 3b
Do you agree that the Board should develop standards that would be suitable for all entities that do not have public accountability and should not focus only on some entities that do not have public accountability, such as only the relatively larger ones or only the relatively smaller ones? If not, why not?

We disagree with the proposal in the Paper that the Board should develop separate standards that would be suitable for all entities that do not have public accountability. We believe the Board should focus on entities which have no public accountability and are relatively small. This is not to say that the distinction between public accountability and non-public accountability has no place in standard-setting. As paragraph 9 of the Paper notes, IAS 14, IAS 27 and IAS 33 currently provide certain exemptions for entities whose equity or debt securities are not publicly traded. Such matters are neatly handled in only a paragraph or two in each standard. If, as part of its work to date, the Board has identified other provisions in full IFRSs that would not be applicable for non-public accountable entities then paragraphs should be introduced into those standards to give exemption for such entities.

We note that we are not advocating the development of three separate tiers of standards. We believe the current need is for IASB SME standards applicable to SMEs and full IFRSs which may contain as appropriate certain exemptions for non public accountable entities but for whom the great majority of the existing provisions would continue to be relevant.

Question 3c
Do the two principles in preliminary view 3.2, combined with the presumptive indicators of 'public accountability' in preliminary view 3.3, provide a workable definition and appropriate guidance for applying the concept of 'public accountability'? If not, how would you change them?

In our opinion, the proposed principles in preliminary view 3.2 have been over-engineered and are more complex than necessary. As indicated in our comments above, the Board recognises in existing standards the difference between entities whose equity or debt securities are publicly traded and those that are not. We believe that this is a straightforward and appropriate definition of public accountability. Furthermore, the subjectivity which pervades the preliminary views in paragraph 28 of the Paper would not be present.

We note that entities should be ineligible to be regarded as SMEs if they meet any of the following criteria:

- its equity or debt securities are, or are in the process of being, publicly traded;
- 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; or
- it is a public sector or government or not-for-profit entity.

Thereafter, we suggest that the Board challenges national standard-setters and regulators to consider whether any other tests, including size criteria, are necessary for determining whether entities within a national jurisdiction should be eligible to use the IASB Standards for SMEs.

The Board requires a working definition of what is an SME. As we have noted above, we suggest it should adopt solely for its purposes the definition of SME in European legislation to provide a broad understanding of the quantified thresholds for such entities.

Question 3d
Do you agree that an entity should be required to use full IFRSs if one or more of the owners of its shares object to the entity's preparing its financial statements on the basis of IASB Standards for SMEs. If not, why not?

We do not support the preliminary view 3.4 that the assent of all owners should be obtained for using the IASB Standards for SMEs. We believe that this is a matter for national regulators and standard-setters to determine. The IASB's role should be to write accounting standards for SMEs, the objective of those financial statements is to report on the stewardship of management. In addition to believing that such a test is inappropriate for the IASB to promulgate, we also believe that it would be impractical in certain jurisdictions to ensure that all owners are contacted and that none have objected to the use of such standards.

Question 4
Do you agree that if IASB Standards for SMEs do not address a particular accounting recognition or measurement issue, the entity should be required to look to the appropriate IFRS to resolve that particular issue? If not, why not, and what alternative would you propose?

We disagree with the view that there should be mandatory fallback to full IFRSs for all issues not covered in Standards for SMEs. If mandatory fallback is retained, then the burden on SMEs is merely increased. Furthermore there is a risk of inappropriate financial reporting as the key objectives of the two regimes are slightly different. We strongly support the second approach that the entity should use its judgement to develop and apply an accounting policy that is suitable in such circumstances.

Question 5a
Should an SME be permitted to revert to an IFRS if the treatment in the SME version of the IFRS differs from the treatment in the IFRS, or should an SME be required to choose only either the complete set of IFRSs or the complete set of SME standards with no optional reversion to individual IFRSs? Why?

and

Question 5b
If an SME is permitted to revert to an IFRS, should it be:

(a) required to revert to the IFRS in its entirety (a standard-by-standard approach);

(b) permitted to revert to individual principles in the IFRS without restriction while continuing to follow the remainder of the SME version of the IFRS (a principle-by-principle approach); or

(c) required to revert to all of the principles in the IFRS that are related to the treatment in the SME version of that IFRS while continuing to follow the

remainder of the SME version of the IFRS (a middle ground between a standard-by-standard and principle-by-principle approach)?

Please explain your reasoning and, if you favour (c), what criteria do you propose for defining 'related' principles?

The Board's preliminary views are that entities can choose a selection of Standards for SMEs and a selection of full IFRSs, or parts thereof. We believe that this "pick and mix" approach would create non-comparability and confusion, which may lead to rejection of the Standards for SMEs.

We believe that if an entity chooses to adopt Standards for SMEs it should do so in their entirety, unless adopting a particular element would fail to give a true and fair view. We also believe that where this is doubt whether applying the provisions of the Standards for SMEs would be sufficient to give a true and fair view, adequate explanation should be given in the notes to the accounts of the transactions or arrangements concerned and the treatment adopted.

We also note that entities may choose to give more information in their financial statements than that which is required. This right should be encouraged.

Question 6
Do you agree that development of IASB Standards for SMEs should start by extracting the fundamental concepts from the Framework and the principles and related mandatory guidance from IFRSs (including Interpretations), and then making modifications deemed appropriate? If not, what approach would you follow?

Ideally, the correct approach would be to determine the needs of users of SMEs' financial statements and then to write the standards to meet those needs. However, given that there are experiences around the world in writing such differential reporting regimes, it is possible to start with existing IFRSs and develop the SME reporting regime, utilising that experience. On that basis, we support the Board's proposed approach to the development of Standards for SMEs, providing commentators are provided in one package with the complete set of proposed standards to consider.

Question 7a
Do you agree that any modifications for SMEs to the concepts or principles in full IFRSs must be on the basis of the identified needs of users of SME financial statements or cost-benefit analyses? If not, what alternative bases for modifications would you propose, and why? And if so, do you have suggestions about how the Board might analyse the costs and benefits of IFRSs in an SME context?

We agree that the modifications should be based on the identified needs of users of SME financial statements. We believe that the IASB should develop a robust set of criteria or tests to determine what principles should apply to SMEs. Failure to develop early in the process such robust criteria may lead to inconsistent standard-setting.

Question 7b
Do you agree that it is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost-benefit analyses and that the disclosure modifications could increase or decrease the current level of disclosure for SMEs? If not, why not?

We agree that disclosure modifications may increase or decrease the current level of disclosures for SMEs. The test is to have disclosures that meet SME user needs.

Question 7c
Do you agree that, in developing standards for SMEs, the Board should presume that no modification would be made to the recognition or measurement principles in IFRSs, though that presumption could be overcome on the basis of user needs and a cost-benefit analysis? If not, why not?

We disagree that the Board always should begin with the presumption that no modification would be made to the recognition or measurement principles in full IFRSs. The Board's working principle should be that it has the right recognition and measurement principles for users of SME financial statements. In our experience, users are looking for treatments which are meaningful and provide the least cumbersome method of reporting. They wish to be able to recognise the numbers and not to be dazzled by the sophisticated techniques which have been used to produce different numbers which are not instantly recognisable to them.

While we do not envisage many differences in respect of recognition, we can see that for measurement it may be more appropriate in certain cases to advocate historical cost accounting for SMEs as opposed to fair value approaches, at least for the foreseeable future.

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

The IASB Standards for SMEs should be published in a separate printed volume.

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

It is important that the IASB does not allow the two regimes to become entirely separate and thus to follow entirely divergent paths. A table of derivations for the requirements in the Standards for SMEs should be provided as should a list of the major simplifications that have been provided from full IFRSs. We do not believe that it would be helpful to the users of such standards for the material to be organised in accordance with current IAS/IFRS numbers.

We urge the IASB to produce a concise standard for SMEs and to build on the best of approaches developed by national standard–setters (e.g., the UK's Financial Reporting Standard for Smaller Entities) We urge the Board to build on all that experience and to develop an International Financial Reporting Standard for SMEs.

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

As noted above, we do not favour an approach in which there is an SME equivalent for every IFRS, IAS, SIC and IFRIC. If such an approach is promulgated, and each document contains a statement of its objective, a summary and a glossary of key terms, together with basis of conclusions as appropriate, dissenting opinions and the standards themselves, then we fear that the package may constitute many hundreds of pages. While such length might be justified if the standards were capable of application by large non public accountable entities, because we believe the project is for SMEs the Board's aim should be to produce something which is very different from full IFRSs and constituting under 10% of their current length. We are aware that giving a percentage is always difficult. But given the experience gained round the world in writing accounting regimes for SMEs such a target appears perfectly achievable.

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

We are conscious of the Board's heavy workload, and it is difficult to have one group focused primarily on the needs of the capital markets also having to deal with the needs of the SME sector. We also would not wish to see a system whereby the SME standards were subject to constant change as full IFRS progressed. There is a need to have a group focused on SMEs and for Standards on SMEs to be reviewed periodically and amended perhaps no more than once per annum (and preferably only every two years). Such a group could be a committee of the IASB or the IASCF although, if the latter, changes to the constitution would be necessary for this group to have the power to issue a standard. Because of this point and because we instinctively prefer only one standard-setting body, namely the IASB, we advocate a model similar to IFRIC. However it will be necessary for the Board to spend some days focused solely on the SME project to ensure the correct foundations are in place.