

4 July 2005

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

[commentletters@iasb.org](mailto:commentletters@iasb.org)

Dear Paul

Deloitte Touche Tohmatsu is pleased to comment on the *Staff Questionnaire on Possible Recognition and Measurement Modification for Small and Medium-sized Entities (SMEs)* (the Questionnaire). We refer you to our comment letter on the discussion paper issued in 2004 *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* date 10 September 2004 for details of our preferred approach to the Board's project on SMEs.

We continue to support the IASB in their efforts to develop an appropriate and comprehensive reporting regime for SMEs (as defined in paragraph 1 of the Questionnaire.) However, we are unsure as to whether the definition of SMEs in the Questionnaire encompasses the range of entities that constituents had hoped would be assisted by this project. Furthermore, we believe that the phrase 'non-securities regulatory filing purposes' (paragraph 1 of the Questionnaire) should be clarified prior to inclusion in any final pronouncement issued by the IASB. Many jurisdictions require all companies, irrespective of size, to file financial reports with a securities regulator. We believe that the IASB intends that the SME standard will not be appropriate for small entities filing accounts with local regulators in compliance with a solely administrative requirement but this is not clear from the drafting.

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 IFRS, with their focus on providing information for making economic decisions in the context of developed capital markets, 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 financial reporting which is likely to be meaningful and comprehensible 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. We hope that the outcome of this project will be a simplified accounting regime which provides entities with a means of communicating financial information to their stakeholders in a manner appropriate to that entity's nature.

In our comment letter we have detailed a number of accounting choices which we believe should be left open for SMEs. We note that where an SME chooses a particular accounting model, that decision ought to be treated as an accounting policy choice and applied consistently by that SME in respect of all similar transactions.

We would like to have a clarification from the Board with regards to the applicability of Interpretations for the purposes of SME financial statements. One interpretation in particular that may cause some concern for SMEs is IFRIC 4. Given that many smaller SMEs exist purely to serve one large client, a requirement to apply IFRIC 4 will raise difficult questions, especially given that the measurement complexities involved in "converting" PPE into finance lease receivables. A possible solution to this particular issue would be to require detailed disclosure of the nature of the relationships of SMEs with their customers, including duration of the projects, guaranteed incomes and level of investment from the SME. However, we note that this exemplifies the need for broader consideration of the applicability of IFRIC Interpretations. We recommend that in the first instance the IFRIC be asked to consider the applicability of its pronouncements to SMEs and make recommendations to the Board.

We note that once the recognition and measurement requirements for SMEs have been determined, the disclosure requirements of all standards need to be revisited to ensure that the disclosure requirements for SMEs:

- are not unnecessarily onerous; and
- provide adequate compensatory disclosure where recognition and measurement requirements have been simplified.

Deloitte Touche Tohmatsu would be delighted to be involved in round table discussions of this issue to be held later this calendar year.

Our responses to the questions contained in the Questionnaire are contained in the Appendix to this letter.

If you have any questions concerning our comments, please contact the under signed in London at +44 207 007 0907

Sincerely,

A handwritten signature in black ink, appearing to read 'Ken Wild', written over a horizontal line.

Ken Wild,  
Global IFRS Leader

**Question 1:**

**What are the areas for possible simplification of recognition and measurement principles for SMEs? In responding, please indicate:**

- **the specific accounting recognition or measurement problem for an SME under IFRSs;**
- **the specific transactions or events that create the recognition or measurement problem for an SME under IFRSs;**
- **why is it a problem; and**
- **how that problem might be solved.**

IAS 2 Inventories

While IAS 2 is on the list of potential issues in Attachment A, we do not believe any simplification of that Standard is necessary in the SME Standard.

IAS 11 Construction Contracts

We believe the requirement to measure contract revenue with reference to stage of completion of the contract in many cases results in un-necessary estimation techniques that will not deliver commensurate benefits to users. Whilst large construction companies reporting under full IFRS are likely to have established mechanisms for determining stage of completion, smaller entities operating possibly only one or two contracts in a year are less likely to have such well-established processes. Accordingly, their estimation techniques as to stage of completion will either involve their own estimate developed without an established process, or alternatively, require the services of an external expert. Where self-estimation techniques are used without established internal control procedures the information will not be readily auditable. Furthermore, as the duration of construction contracts for SMEs is likely to be relatively short, the use of the percentage of completion method may not provide beneficial additional information to users. Accordingly, we believe that it would be more appropriate for SMEs to have the option to apply IAS11.32 in respect of all construction contracts – that is their only accounting model would be that used for full IFRS when the stage of completion cannot be measured reliably.

This comment applies equally to the measurement of services revenue in IAS 18 – we believe that SMEs should have the option to measure this revenue as required by IAS 18.26

IAS 12 Income Taxes

We do not believe the recognition of deferred taxes in accordance with IAS 12 provides users with useful information in the context of an SME. The decisions being made by users are unlikely to be significantly affected by the existence of such tax balances, and the requirement to comply with IAS 12 would introduce a significant degree of complexity to the SME standards. We believe that entities should be required to make a reasonable estimate of current taxes and recognise this as a liability. We suggest that such a reasonable estimate could be made based on completed tax return (where this is completed prior to the preparation of the financial report), or, as a fall back, on the basis of prior average effective tax rates. The entity should be required to disclose the existence of unused tax credits, and the extent to which management expect the effective tax rate to change significantly in the foreseeable future.

### IAS 17 Leases

We believe that the distinction between operating leases and finance leases currently contained in IAS 17 should be retained. We would propose that SMEs be permitted to use their own incremental borrowing rate rather than the rate implicit in the lease as the discount rate in determining the present value of the minimum lease payments. Furthermore, in determining the assets and liabilities to be recognised at inception of a finance lease we believe SMEs should be permitted (but not required) to recognise the assets and liabilities at the present value of the minimum lease payments, (that is, they should be granted an exemption from the requirement to determine the fair value of the leased asset). We believe these proposals will reduce the complexity involved in accounting for leases without significantly undermining the quality of the financial information provided.

We do believe that the requirement to recognise operating lease expense on a straight line basis should be retained. We do not believe this requirement is unduly complex, and we believe it results in a more accurate representation of the actual expense to which the entity has contracted in respect of each year.

### IAS 19 Employee Benefits

In respect of long term employee benefits and defined benefit schemes, we do not believe the separate recognition of a number of components of the expense (as per IAS 19.61 and 19.129) is necessary. We believe the long term employee benefit obligation should be measured at its fair value, less that of any plan assets, at each balance sheet date. The movement between the balance sheet dates is the actual expense to the entity and is accordingly the amount to be recognised – further disaggregation is of little value. We believe that SMEs should not be required to use the projected unit credit method to determine the present value of their defined benefit obligations and related current and past service costs. We believe that SMEs should be permitted to use other acceptable actuarial methods in determining these values.

### IAS 23 Borrowing Costs

We support the deletion of the capitalisation model for borrowing costs from IFRS for SMEs. We understand that many SMEs enter into very general financing arrangements, and therefore determining the appropriate costs for capitalisation could be problematic. We do not believe the use of this method will provide sufficiently useful information to users to support its retention.

### IAS 27 Consolidated and Separate Financial Statements

We do not believe that the IFRSs for SMEs should incorporate a requirement to consolidate subsidiaries. We believe that in some cases consolidation is an arduous and time consuming process which would provide little benefit to the users. Instead, we believe that the entities should be allowed either to consolidate all subsidiaries, or to disclose the names of unconsolidated subsidiaries and carry these as investments in accordance with the requirements of IAS 39 as developed for SMEs.

We note that some jurisdictions may seek to mandate consolidation of subsidiaries in SMEs; we believe that this is an issue which should be addressed at a jurisdictional level – rather than a concern of the IASB.

IAS 28 Investments in Associates & IAS 31 Interests in Joint Ventures

We do not believe that the IFRSs for SMEs should incorporate a requirement to equity account for associates and joint venture arrangements. We believe that in some cases equity accounting is an arduous and time consuming process which would provide little benefit to the users. Instead, we believe that entities should be allowed either to equity account for all such arrangements, or to disclose the names of entities meeting the definitions of associate and joint venture found in IAS 28 and IAS 31 respectively and carry these as investments in accordance with the requirements of IAS 39 as developed for SMEs..

We note that some jurisdictions may seek to mandate equity accounting of associates and joint venture entities in SMEs; we believe that this is an issue which should be addressed at a jurisdictional level - rather than a concern of the IASB.

IAS 32 Financial Instruments: Disclosure and Presentation

We do not believe the requirement to split a compound instrument into its component parts provides useful information to users of SME accounts, as this activity merely provides a conceptual split which does not bear direct relation to the entity's perceived transaction and cash flows. We believe that where an SME has a financial instrument outstanding which would be required to be accounted for as a compound instrument in accordance with IAS 32 the entity should be permitted either to account for the instrument in accordance with the requirements of IAS 32, or to account for the entire instrument as a liability.

IAS 36 Impairment of Assets

We believe the inclusion of the impairment requirements for indefinite lived intangible assets and goodwill may be inappropriate at this time. The impairment testing requirements are very complex, and to satisfy them most SMEs would require the assistance of external parties, which comes at a substantial cost. Accordingly, we support a requirement for an amortisation period of not longer than twenty years for goodwill and indefinite lived intangibles at this time, supported by impairment testing only where a trigger for impairment has occurred during the period. We believe that for many SMEs this regular profit or loss hit will be preferable to a regular cash outflow to external experts to complete the impairment testing.

Furthermore, we believe that where a trigger for impairment testing has occurred during the period, SMEs should be permitted to use a simplified method for determining value in use. This could include the introduction of simple valuation methods to assist SMEs in determining whether a detailed IAS 36 calculation is necessary. We would also recommend that entities be permitted to use their own incremental borrowing rate as the applicable discount rate.

IAS 38 Intangible Assets

We do not believe the requirements in IAS 38 to capitalise development expenditure are necessary for SMEs. We believe that undue effort could be directed toward proving (or disproving ) that the criteria for recognition have been met. Accordingly we believe that SMEs, to capitalise the development expenditure that meets the criteria in IAS 38, or, as an acceptable alternative treatment to expense all research and development expenditure.

IAS 39 Financial Instruments: Recognition and Measurement

IAS 39 is a complex standard. We do not support the promulgation of a second standard which contains some, but not all, of the complexities of IAS 39. We do not believe that sub-categorisation of financial assets into a range of alternatives each with different accounting

implications will provide information that is useful to users, and such an activity, as is well documented, is costly.

IAS 39 is based on a mixed measurement model, and we believe that a single measurement model is needed for SMEs. Based on IAS 39, the available measurement models are cost or fair value. To require fair value for all financial assets and financial liabilities would be more onerous than is required for entities applying IAS 39 in full, and we therefore believe that SMEs should be required to measure all financial assets and financial liabilities at amortised cost using an effective interest rate method. We acknowledge that this will give rise to some items not being recognised on balance sheet (such as foreign exchange contracts). However, we believe that genuine simplification is necessary for SMEs, and the resulting recognition anomalies should be alleviated by way of compensating disclosure.

We note that the derecognition and impairment requirements of IAS 39 should be retained for SMEs, as these are required for the accounting required for SMEs to be consistent with the *Framework*.

If full IAS 39 is not included in IFRSs for SMEs we believe the existence of derivatives should be required to be disclosed. Furthermore, SMEs should be encouraged to disclose the fair value of all financial instruments held in order for users to get a sufficient idea of the magnitude of the possible impact of realising the profits or losses associated with those financial instruments.

#### IAS 40 Investment Property

While IAS 40 is not on the list of potential issues in Attachment A, we do wish to specifically comment that we believe investment property markets in many jurisdictions are sufficiently well developed to allow for the application of IAS 40 in full without undue cost to SMEs, particularly given that IAS 40 permits both a cost option and a fair value option. However, as we are aware of some jurisdictions in which it is not practicable to determine a fair value for investment properties, we believe the requirement to disclose the fair value of investment properties when the cost model has been used should have an impracticability exemption in the SME Standard.

#### IAS 41 Agriculture

We do not believe that the fair value method of accounting for biological assets and agricultural produce at point of harvest should be required in IFRSs for SMEs. We believe that determining fair value, and point of sale costs, is a costly and time-consuming task and to our minds un-necessary for these types of preparers. Accordingly we believe biological assets should be measured at their cost, less accumulated depreciation and impairment losses (as IAS 41.30 permits where fair value cannot be measured reliably.)

#### IFRS 1 First-time Adoption of International Financial Reporting Standards

We believe the requirement for full retrospective application of IFRS for a first-time SME adopter to be onerous and suggest a simplification of the procedure, mainly based on a “forward-looking” approach. However, to ensure coherence in matters essential to SMEs (Inventories, PPE) with regards to their measurement, a once-off adjustment at the date of transition may be appropriate.

### IFRS 3 Business Combinations

We believe that the requirement to recognise all intangible assets held by the acquirer following on from a business combination may result in a lot of additional valuation work being performed which results in minimal differences to the final accounting for the business combination. Accordingly, we believe that SMEs should be permitted either to apply IFRS 3 in full, or to only recognise intangible assets that would be recognised as assets of the acquiree. We note that the accounting impacts of this simplification will be partly offset by the proposed requirement to amortise goodwill.

### IFRS 5 Non current Assets Held for Sale and Discontinued Operations

The recognition and measurement requirements for non current assets classified as held for sale were not addressed in the questionnaire. We believe that a simplified approach could be applied to SMEs, notably, that unless a binding sale agreement has been obtained, no reclassification be allowed. Following such classification, the measurement at “fair value less costs to sell” should be restricted to the amount in the binding sale agreement.

## **Question 2**

**17. From your experience, please indicate which topics addressed in IFRSs might be omitted from SME standards because they are unlikely to occur in an SME context. If they occur, the standards would require the SME to determine its appropriate accounting policy by looking to the applicable IFRSs.**

We believe that the IFRS 2 *Share-based Payment* does not require equivalents in the SME regime due to the rarity of these transactions in SMEs. We believe that where an SME encounters share-based payments they should use the revised hierarchy as proposed for the SME version of IAS 8 (and we acknowledge that this would generally require the application of full IFRS 2). In general we believe that where an entity is sophisticated enough to enter into these transactions, they should be able to complete the accounting requirements without undue cost. However, we do note that where SMEs are required to apply IFRS 2, we would expect a substantial proportion of those SMEs to default to the use of intrinsic value as required by IFRS2.24 in situations where the fair value of the equity instruments granted cannot be reliably measured.

We believe that the following standards do not require equivalents in the SME regime due to the fact that their very application indicates the entity does not meet the definition of an SME as described in paragraph 1 of the Questionnaire

- IFRS 4 *Insurance Contracts*;
- IAS 26 *Accounting and Reporting by Retirement Benefit Plans*; and
- IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.