

INVITATION TO COMMENT

**FINANCIAL REPORTING FOR
SMALL AND MEDIUM-SIZED
ENTITIES (SMEs) – PROPOSED
PROCESS**

May 2007

The proposed process for financial reporting for SMEs has been issued by the South African Institute of Chartered Accountants (SAICA) for public comment. The exposure draft issued by SAICA is released for public comment by the Accounting Practices Committee (APC).

Comments received on the proposed process will be considered by the APC when recommending this proposed process for approval by the Accounting Practices Board (APB).

One copy of written comment should be addressed to:

Project Director – Accounting
File Reference APC – ED 225
P O Box 59875
KENGRA
2100

Comments can also be emailed to:

sharonr@saica.co.za

Your comments should be received by no later than **18 June 2007**. All replies will be regarded as being on public record unless confidentiality is requested.

INVITATION TO COMMENT

The APC invites comments on any aspect of this proposed process. This invitation to comment is on the proposed interim process to early adopt the International Accounting Standard Board's (IASB's) ED 222 – *International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SMEs)* and is not requesting comments on the *IFRS for SMEs* itself. Comments on ED 222 should be submitted in a separate comment letter to SAICA. See details below under the “Opportunity to Comment on the *IFRS for SMEs* Exposure Draft” section at the end of this document.

Before commenting on the questions below we recommend that commentators refer to ED 222 and the staff overview of this exposure draft, prepared by Paul Pacter, IASB Director of Standards for SMEs (see “Opportunity to Comment on the *IFRS for SMEs* Exposure Draft”).

Comments on this exposure draft should be submitted in writing and should be received no later than **18 June 2007**.

Question 1

Do you agree with the proposed interim process? The proposal is to early adopt the *IFRS for SMEs* in its exposure draft form. This is considered necessary so that the need for differential reporting standards for limited interest companies can be addressed, in terms of the Corporate Laws Amendment Act (Amendment Act), until the Financial Reporting Standards Council is established in terms of the Amendment Act and this Financial Reporting Standards Council advises on or develops accounting standards for limited interest companies.

Please provide reasons for your response, whether you responded “yes” or “no” to Question 1.

Question 2

If your response to Question 1 was “no”, in your opinion, what would be a more appropriate standard for limited interest companies, considering that these companies are required to be audited and the auditors are required to express a “fairly presents (ISA 700) opinion” in terms of a recognised framework?

Introduction

- .01 In the Communiqué of 22 February 2007 entitled “*IASB publishes draft IFRS for SMEs*”, reference was made to SAICA being in the process of defining its strategy with regard to the IASB’s *IFRS for SMEs* exposure draft. The communication also indicated that SAICA was aware of members’ concerns that Statements of Generally Accepted Accounting Practice (GAAP) were unduly burdensome for smaller companies and that SAICA had therefore established an SME Financial Reporting Task Team. The task team’s objective was to provide a reporting framework for limited interest companies until the new Financial Reporting Standards Council, to be established in terms of the Corporate Laws Amendment Bill (at the time), issued standards for limited interest companies.
- .02 Subsequently, the Amendment Act was signed into law, as communicated to members by SAICA on 12 April 2007. However, the implementation date of the Amendment Act is still to be published. Until such time the status quo remains and all companies have to prepare financial statements in accordance with Statements of GAAP or International Financial Reporting Standards (IFRS), as required by the Companies Act, 1973. This requirement is in terms of section 286 of the Companies Act, read in conjunction with paragraph 5 of Schedule 4 to the Companies Act. Paragraph 5 of Schedule 4 will be deleted by the Amendment Act, once effective.

Requirements of the Corporate Laws Amendment Act

- .03 Section 34 of the Amendment Act introduces a new section 285A to the Companies Act and subsection 2 states, “*a limited interest company –*
- (a) *must comply with accounting standards developed for limited interest companies under section 440S(1)(b);*
 - (b) *must comply with the provisions of this Act and Schedule 4 that are applicable to limited interest companies;*
 - (c) *must prepare financial statements that fairly present the financial position and the results of operations of the company (and its subsidiaries, if applicable) in accordance with paragraphs (a) and (b).”*

However, as accounting standards have not yet been developed for limited interest companies, the following transitional provisions apply in terms of section 56(3)(a) of the Amendment Act:

“Prior to the development of accounting standards contemplated in section 285A(2)(a), a limited interest company must prepare its financial statements in accordance with a set of accounting practices adopted by that company, which must comply with the framework for the preparation and presentation of financial statements included in financial reporting standards.”

The SAICA position

After consulting with the APC and Ad-hoc Committee on Corporate Law to determine what guidance should be given to members in the transitional period until the Financial Reporting Standards Council is established and issues standards for limited interest companies, SAICA’s view is as follows (please note that this would only become applicable after the implementation date of the Amendment Act (once announced)):

- (1) A limited interest company could:
 - continue to comply with either of the current reporting frameworks, Statements of GAAP or IFRS, or
 - early adopt the *IFRS for SMEs* in its exposure draft form, which would be more suitable and provide some relief from reporting in terms of the current frameworks noted above.

Financial statements that are not prepared in terms of a comprehensive accounting framework would make it difficult for auditors to express an audit opinion on whether the financial statements of the company are a fair presentation in terms of a recognised framework, and a modified audit opinion would be inevitable. In its current exposure draft format, the *IFRS for SMEs* is not a financial reporting framework, since the document has not completed due process. However should the APB, the authority in South Africa that is responsible for issuing accounting standards, recommend that limited interest companies early adopt the *IFRS for SMEs* in its exposure draft form as a means of complying with the transitional provisions in section 56(3)(a) of the Amendment Act, this will enable the auditor to

consider issuing a “fairly present” audit opinion as required by section 285A(2) of the Amendment Act.

- (2) Limited interest companies would be likely to face further changes later, if the standards issued by the Financial Reporting Standards Council require a higher level of reporting from that which companies choose to report on in the transitional period, if such companies did not apply one of the reporting framework options set out in the bullets in point 1 above. It is our understanding that when the next draft of the Companies Bill, 2007 will have similar requirements.
- (3) SAICA will consider all comments received as a result of exposing the proposed process. On the basis of the comments received, SAICA will consider recommending to the Accounting Practices Board (APB) that it adopt the *IFRS for SMEs* in its exposure draft form, as a transitional standard for limited interest companies until the Financial Reporting Standards Council is established.
- (4) On the basis of the outcome from (2) above, SAICA will recommend to the Financial Reporting Standards Council, once established, that it should adopt the *IFRS for SMEs* in its exposure draft form as the initial standard for limited interest companies. SAICA will also recommend to the Financial Reporting Standards Council that it adopts the final standard on the *IFRS for SMEs*, once this has been issued by the International Accounting Standards Board (IASB).

Interim Process

- .06 This proposal is to adopt the *IFRS for SMEs* in its exposure draft form, as issued by the IASB without any amendments. Therefore, SAICA will not consider proposed amendments to the exposure draft when recommending this to the APB, as part of this process. Should you wish to comment on ED 222 – *IFRS for SMEs*, please see the “Opportunity to Comment on the *IFRS for SMEs* Exposure Draft” section below. In addition, in terms of the proposed process no amendments will be made to the exposure draft when recommending it to the APB. It will be recommended that limited interest companies

will be required to comply with the exposure draft as issued, until the final standard is published.

Reason for the SAICA Position

SAICA is of the view that early adoption of the *IFRS for SMEs* in its exposure draft form is the best transitional option for limited interest companies, until the Financial Reporting Standards Council is established and the Financial Reporting Standards Council issues standards for limited interest companies, for the following reasons:

- SAICA's initial concern was that the IASB project's timeframe would not meet the urgent timing need for South Africa in respect of the relief provided to limited interest companies in terms of the Amendment Act. However, this concern was alleviated as the IASB has given top priority to developing a standard for SMEs and has expedited this project. The final standard is anticipated in 2008.
- Further concerns that the IASB project would not provide adequate relief for South African limited interest companies have been addressed. The exposure draft provides disclosure relief, simplifies many recognition and measurement criteria, removes choices for accounting treatment, and eliminates topics that are generally not relevant to SMEs.
- The proposed *IFRS for SMEs* exposure draft addresses another concern regarding a mandatory fallback to full IFRSs, if the *IFRS for SMEs* standard does not address a specific matter. This mandatory fallback requirement has been removed.
- It is evident that the IASB is committed to taking cognisance of the views of commentators around the world, many of whom have comments similar to those from South Africa. It may be likely that the final standard provides further relief from the current exposure draft. However, if this is not the case, consideration could still be given as to whether the South African requirement could be modified to provide additional relief to limited interest companies.
- SAICA's view is that it would be unfair to start at a lower reporting requirement level and increase the requirement however, the opposite is acceptable. The proposal allows for additional reporting relief in future, as explained above.

- The APB took a decision many years ago to move away from standard setting in South Africa and instead issues international standards as Statements of GAAP in order to enhance the credibility of South African reporting in the global arena. As a result, South Africa does not have the capacity to maintain an independent local set of standards that are not based on or linked to international standards at this time. Therefore, in light of the decision to adopt international standards, adopting the *IFRS for SMEs* would be appropriate.
- In the interest of the credibility of financial reporting in South Africa, the use in South Africa of an internationally recognised standard, such as the *IFRS for SMEs*, will enhance the development of and investment in our economy.

Opportunity to Comment on the *IFRS for SMEs* Exposure Draft

- .08 SAICA members and other interested parties have an opportunity and are encouraged, to consider the content of ED 222 – *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*.

A staff overview of the exposure draft prepared by Paul Pacter, IASB Director of Standards for SMEs, can be found on the SAICA website (www.sacia.co.za).

Should you wish to comment you may do so to:

- SAICA: sharonr@saica.co.za, by 1 September 2007, or
- the IASB: (www.iasb.org), using the “Open to Comment” page, by 1 October 2007.

Opportunity to Attend a Discussion Forum with the IASB Director

- .09 The IASB has shown its commitment to hearing the South African views. SAICA, in partnership with the South African Institute of Public Accountants (SAIPA), has arranged for Paul Pacter, the IASB’s Director of Standards for SMEs, to conduct two education/discussion forums in South Africa. These sessions will provide an overview of the main areas of relief for SMEs and will afford the opportunity for

members to comment directly to the IASB to present South African views. These sessions will be held on:

- 31 May 2007 in Johannesburg at the Sandton Convention Centre;
- 1 June 2007 in Cape Town at the BMW Pavillion at the Waterfront.

Additional Discussion Forums

Additional education/discussion forums will be held around the country .10 facilitated by members of the SME Financial Reporting Task Team.

Details of the above sessions will be advertised separately to members.