

Peter Godsall  
Accounting Standards Board  
5<sup>th</sup> Floor  
Aldwych House  
71-91 Aldwych  
London  
WC2B 4HN

Our ref INS/ACS/gs

29 June 2007

Dear Sir

## **Consultation Paper: IASB Exposure Draft of a proposed IFRS for small and medium-sized entities**

We write in response to the invitation to comment on the potential implications for UK and Irish entities of the Exposure Draft of a proposed IFRS for small and medium-sized entities published in February 2007 (the 'SME ED'). In the Appendix to this letter we set out our responses to the specific questions raised by the ASB. We welcome the SME ED and support the approach the IASB has taken in developing a simplified, self-contained set of accounting principles. Deloitte comments on the SME ED will be included within our international submission to the IASB, a copy of which we will provide to the ASB.

There is no case for two sets of wholly different standards (IFRS and UK GAAP) in the medium term in the UK and we support the ASB's decision to consider an appropriate exit strategy for UK GAAP. The ASB rightly deferred making any binding decisions over whether IFRS should be introduced for all companies for periods beginning on or after 1 January 2005 but the time has come to make a decision over the future of UK GAAP and the ASB needs to show leadership over the issue. Valuable lessons can be learnt from 2005 when IFRS was introduced. A stable set of standards needs to be established and be in steady state for at least two years prior to enforcement. Early adoption could be encouraged but not mandatory. We also need to be mindful of the costs versus the benefits of introducing a new accounting regime for companies. We do not want to increase the burden for small companies.

We support the continued use of a three-tier system in the UK and that it should be as follows:

1. full IFRS for listed and publicly accountable groups and entities;
2. IFRS SME standard for large and medium private companies, including subsidiaries of listed and publicly accountable entities (the 'middle tier'); and
3. FRSSE for small companies.

There is a legal requirement for small companies to prepare and file accounts in the UK. The SME standard has not been written with this type of entity in mind; it was drafted on the basis of a 50 employee company. As the SME ED is longer and more complex than the UK's FRSSE which serves reasonably well small companies, it should not replace the FRSSE at this time. The detail supporting this view is included within our answers to the questions, posed in the ASB Consultation Paper, in the Appendix to this letter.

We believe that, to arrive at a sensible accounting framework in the UK, legal changes need to be made. Full IFRS can already be used by all entities as a standalone set of standards, i.e. bypassing most of the detailed accounting requirements set out in company law. We believe British companies would be better served if the accounting framework for those within the scope of the SME standard could also be contained within one document as opposed to companies needing to refer to the detailed accounting requirements within Schedules 4 and 4A of the 1985 Companies Act as well as the accounting standards. Therefore there is a need to lobby the Department for Business, Enterprise and Regulatory Reform (DBERR) and the European Commission to amend the 2002 IAS Regulation to allow the SME standard to be used directly or to achieve this effect by some other route. It would be beneficial if the legal changes were brought in at the same time as the UK was to adopt the standard based on the SME ED.

If you have any queries on our comments, please contact Isobel Sharp (020 7007 0894) or Amanda Swaffield (020 7303 5330).

Yours faithfully

*Deloitte & Touche LLP*

## Appendix

### **Responses to the specific questions in the Consultation Paper on the IASB Exposure Draft of a proposed IFRS for small and medium-sized entities**

#### **Question 1 – IFRS SME for the 'middle-tier'?**

*Do you believe that the proposed IFRS for SMEs would be suitable for 'middle tier' entities that fall between applying full IFRS and the FRSSE?*

The ED defines 'SMEs' as entities that i) do not have public accountability; and ii) publish general purpose financial statements for external users. We agree that IFRS SME is appropriate for such entities.

The term 'SME' is misleading as it means something different to different countries. In Europe, small and medium-sized companies are clearly defined within company law as driven by the EU Company Law Directives. The companies that fall within this definition must meet certain size criteria and those that qualify as small have the option of applying the FRSSE in the UK. If a three-tier approach is adopted, the number of companies that would fall within the definition of 'SME' for the SME ED is much larger than those that would qualify as 'medium' in accordance with the definition of the 1985 Companies Act, for example, large unlisted entities would be eligible to adopt the SME standard.

We agree with the scope as set out in the ED but believe the title of the document should reflect better the entities which are within its scope. Referring to SMEs is misleading and for this reason we believe that substituting 'non publicly accountable entities' (NPAAE) for 'SME' would be helpful.

In the preface to your Consultation Paper you state that *'UK and Irish subsidiaries of group companies that apply full IFRS would also be required to apply full IFRS in respect of measurement and recognition, but with reduced disclosure requirements (yet to be defined). Consequently, the IFRS for SMEs would not be an available option for these subsidiaries'*. We believe that subsidiary entities should not be treated differently from other private companies and that it is appropriate for subsidiaries of companies applying full IFRS to follow the same regime as 'middle tier' companies, given the SME ED is essentially full IFRS with less disclosure. We acknowledge that the SME ED could be amended for application in the UK and Ireland to include some specific exemptions applicable only to subsidiaries meeting certain criteria. For example, the current exemption from preparing a cash flow statement could be perpetuated. In our view, while cases can be made for such exemptions, the prize of international consistency overrides such arguments. Thus, the UK should not tinker with the IASB's standard.

Publicly accountable entities which do not have listed securities comprise largely financial institutions. We agree that it is appropriate for large financial institutions to apply IFRS.

We have concerns over whether small financial institutions should be burdened with a full IFRS and believe this needs to be considered further.

**Question 2 – proposed changes to the SME Standard for application by the 'middle'tier'**

*If the proposed IFRS for SMEs were to be considered a suitable basis for middle tier companies, what specific changes do you think the ASB should be proposing; for example is it too long, is there too much cross referencing to full IFRS, are there sufficient simplifications, etc?*

See our answer to question 1 for our comments on title and application for subsidiary companies.

The IASB expects to publish an omnibus exposure draft of proposed amendments to the SME standard approximately every other year and we support this proposal. However, a 'stable platform' is required during the period leading up to implementation of the SME standard and so changes made to the underlying IFRS during this time should not be tracked automatically to the standard effective in the UK.

Deloitte comments on the detail of the draft SME standard will be included in our submission to the IASB, a copy of which will be provided to you in due course.

**Question 3 – replacement for the FRSSSE?**

*Do you believe that the proposed IFRS for SMEs would be a suitable replacement for the FRSSSE?*

We do not agree that the SME standard as drafted is appropriate as a replacement for the FRSSSE. There is no evidence to suggest that the FRSSSE is not working, albeit the Professional Oversight Board's 2006 research suggests some further simplification and clarity on deferred tax and inventory may be welcomed. The costs of change for a small company required to use the SME ED are likely to outweigh any benefit given that the SME ED is more complex than the UK FRSSSE. If anything, we think the FRSSSE should be simplified further. The argument based on the need for cross border comparability within markets is not so relevant for small companies.

There is still a case for the FRSSSE in the UK to be retained as part of a three-tier system, as a legal requirement exists for even the smallest owner-managed companies to prepare general-purpose financial statements. Furthermore, small companies may be required to prepare financial statements to submit them to the tax authorities.

The IASB's Basis for Conclusions to the SME ED states that the SME ED is appropriate for use by 'micro' entities. We would dispute this in practice in the UK. Replacing the FRSSSE with the IFRS for SMEs would, based on the SME ED, cause a credibility problem for the ASB and would lead to poorer accounting as preparers and others struggle with the

relative complexity of the IFRS. We agree that this decision should be reconsidered in say five years' time. We suggest in time that the FRSSE could evolve into a slimmed-down version of the SME standard, adopting international language.

#### **Question 4 – proposed changes to the SME Standard for application by FRSSE companies**

*If the proposed IFRS for SMEs were to be considered a suitable basis for the FRSSE, what specific changes to you think the ASB should be proposing; for example is it too long, is there too much cross referencing to full IFRS, are there sufficient simplifications, etc?*

We do not agree that the proposed IFRS for SMEs should be a replacement for the UK FRSSE. If it were to be considered, then drastic simplifications would be required so that it is simple and straightforward to apply to meet the needs of small companies. The simplifications would include:

1. the removal of the requirement for small groups to prepare consolidated accounts, which is particularly onerous. In fact, three sets of individual accounts will give more information than consolidated accounts particularly given that there is no requirement for segmental analysis in the SME standard;
2. simplification (or possible elimination) of the requirement to recognise deferred tax on temporary differences, which is a frequent source of confusion;
3. introduction of systematic amortisation for goodwill and intangibles;
4. removal of equity-settled share based payment measurement rules; and
5. requiring fair value measurement only when it is readily determinable without due cost or effort. This is the approach to be used for biological assets in the SME standard.

This list is not exhaustive but merely illustrates some areas where the SME standard is too onerous for 'small' companies. Furthermore, the language would need to be simplified as it is currently drafted using technical language from full IFRS.

#### **Question 5 – Costs vs benefits**

*What do you consider should be the costs and benefits of the ASB adopting the proposed IFRS for SMEs either as (i) a standard for 'middle tier' companies or (ii) a replacement for the FRSSE? Are there any specific areas in the Exposure Draft that would, in your view, impose particular costs on companies? It would be helpful if any significant costs that would arise or any of the specific areas could be identified and quantified.*

As was observed following the introduction of IFRS for listed groups in 2005, considerable costs of conversion such as education, training and systems changes were incurred. Ensuring that there is a stable standard in place for at least two years before it becomes effective would help planning for its implementation and minimise costs being wasted on areas that are changed shortly prior to implementation.

Specific areas in the SME standard that would impose particular costs for a standard 'middle tier' company could include:

1. the requirement to prepare consolidated accounts; and
2. compliance with IAS 12.

The costs for a small company which currently applies the FRSSE would be excessive. Incremental changes that affect a small company often result in additional professional costs, as companies cannot normally draw on in-house expertise. Please also refer to our response to question 4.