



# **An International Financial Reporting Standard for SMEs**

**Paul Pacter**

**IASB Director of Standards for Small and Medium-sized Entities**

**DRSC – Deloitte Conferences**

**Dusseldorf and Frankfurt am Main**

**18 and 19 January 2007**



# Why SME Standards Are Needed

- **Benefits of global accounting standards for listed companies are obvious in globalised financial markets.**
- **Even for unlisted SMEs, financial statements that are understandable across borders are needed:**
  - **Banks make loans across borders and operate multi-nationally.**
  - **Vendors from other countries.**
  - **Credit rating agencies.**
  - **Overseas customers.**
  - **Foreign venture capital.**



# Why SME Standards Are Needed

- **Two edged-sword for SMEs:**
  - Good accounting and more disclosure add to SME burdens, not reduce them.
  - SMEs often see greater transparency as 'competitively harmful'.
  - At the same time, good accounting and disclosure give investors confidence to provide capital.
- **Solution: Tailor requirements for SMEs. This is what the IASB SME project is all about.**



# IASB Definition of SME

## ▪ IASB view:

- IFRS for SMEs is appropriate for an entity with no public accountability:
  - not publicly traded; and
  - not a financial institution.
- An entity whose securities are publicly traded has public accountability.
  - Need full IFRSs for investor protection.



# IASB Approach

1. Focus on non-publicly accountable entities that publish general purpose financial statements for external users, including:
  - **Non-manager owners**
  - **Existing and potential lenders and creditors**
  - **Credit rating agencies**
2. Focus on typical SME with about 50 employees in deciding the content of the IFRS for SMEs.



# IASB Approach

3. No quantified “size test”. Each jurisdiction should develop guidelines on which entities will use the IFRS for SMEs.
4. Stand-alone document. No mandatory fallback to IFRSs.
5. Starting point: IASB Framework and standards.



## IASB Approach

6. Material not relevant to typical SME omitted, with cross-references to full IFRSs if needed:

- **Hyperinflation**
- **Equity-settled share-based payment**
- **Agriculture**
- **Extractive industries**
- **Interim reporting**
- **Lessor finance leases**



# IASB Approach

7. Only simpler of options in full IFRS are included. Other(s) cross-referenced. So, only:
- **Cost for investment property.**
  - **Cost for PP&E and intangibles.**
  - **Expense all borrowing cost.**
  - **Indirect operating cash flows.**
  - **One method for all grants.**
- Jurisdictions could eliminate options.**



# IASB Approach

## 8. Recognition and measurement simplifications, page 1 of 2:

- **Financial instruments:**
  - Two classifications, not four
  - Drop “continuing involvement approach” for derecognition
  - Much simplified hedge accounting
- **Goodwill impairment – indicator approach**
- **Expense all R&D**
- **Cost method for associates and JVs**
- **Income taxes – simplified method**



# IASB Approach

## 8. Recognition and measurement simplifications, page 2 of 2

- **Less fair value for agriculture – only if “readily determinable” fair value**
- **Defined benefit plans – principle approach, no corridor tests**
- **Share-based payment – intrinsic value**
- **First-time adoption – less prior data**



# IASB Approach

9. SME must try to find answers in SME standard by analogy and by using pervasive principles.
10. SME may look to full IFRSs as a “safety net” – if answer cannot be found otherwise.
  - **But no mandatory fallback to full IFRSs.**



## Other Issues

- Suitability for micro-SMEs (tiny)
  - **Yes, definitely**
- Usefulness to managers of SMEs
  - **Yes, but not IASB objective**
- Usefulness for tax returns and dividend distribution
  - **Yes, but not IASB objective**



# Rejected Simplifications

- Drop the cash flow statement.
- All leases operating.
- All pension plans defined contribution.
- Completed contract only.
- Fewer provisions.
- Non-recognition of share-based payment.
- Non-recognition of deferred taxes.
- Cost model for all agriculture.
- No consolidation.
- Derivatives at cost.



## The Effort: Due Process

- **Discussion paper on approach.**
  - June 2004. 120 comments received.
- **Recognition and measurement (R&M) questionnaire.**
  - April 2005. 101 responses.
- **Public roundtables on R&M.**
  - October 2005. 45 participants.
- **Working Group**
  - Three meetings
  - January 2006 discussed draft ED two days. 84 recommendations to Board.



## The Effort: Due Process

- **Discussed with World Standard Setters:**
  - 2004, 2005, 2006. Feedback sessions.
- **Discussed with SAC:**
  - 2001, 2003, 2004, 2005, 2006.
- **Board deliberations—public meetings:**
  - 2003 – 4 meetings
  - 2004 – 9 meetings
  - 2005 – 7 meetings
  - 2006 – 9 meetings



# The Result: Draft Exposure Draft

- **The draft ED now:**
  - About 220 pages
    - **Full IFRSs now 2,400 pages.**
  - Organised by topic
  - 38 sections
  - Model financial statements
  - Disclosure checklist



## The Result: Draft Exposure Draft

- **Board indicative vote Oct 2006:**
  - 11-1 (+1 wait to see final draft) in favour of issuing the ED.
- **Draft posted on IASB website in August 2006 and updated November 2006**
  - Stimulate early thinking.
- **Translations of ED in Spanish, French, German.**



## SME Concern: "Maintenance"

- SMEs are worried about frequent updating of IFRS for SMEs:
- Board decision:
  - Update the IFRS for SMEs every 2 years.
  - Omnibus Exposure Draft.



# Next Steps

Tentative dates:

- **Exposure Draft –Early February 2007.**
  - **Comment deadline 30 September 2007.**
- **Field tests and/or visits to SMEs?  
Roundtables?**
- **Final Standard – 1H 2008.**
- **Effective – whenever adopted locally.**



# Thank you. Questions?

EXPRESSIONS OF INDIVIDUAL VIEWS BY MEMBERS OF THE IASB AND ITS STAFF ARE ENCOURAGED. THE VIEWS EXPRESSED IN THIS PRESENTATION ARE THOSE OF DR. PACTER. OFFICIAL POSITIONS OF THE IASB ON ACCOUNTING MATTERS ARE DETERMINED ONLY AFTER EXTENSIVE DUE PROCESS AND DELIBERATION.

