

The IASB Project on Accounting Standards for SMEs

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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 tentative view:

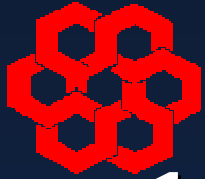
§ IFRS for SMEs is appropriate for an entity with no public accountability:

§ not publicly traded; and

§ not a financial institution.

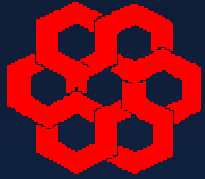
§ An entity whose securities are publicly traded has public accountability.

§ Need full IFRSs for investor protection – even for small listed.



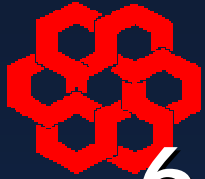
IASB Approach

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 detailed guidelines on which entities are eligible to use.
4. Stand-alone document as much as possible.
5. Framework concepts and pervasive principles added, to minimise need for fallback to full IFRSs.



IASB Approach

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

§ Hyperinflation

§ Equity-settled share-based payment

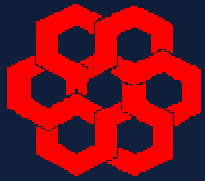
§ Agriculture

§ Extractive industries

§ Interim reporting

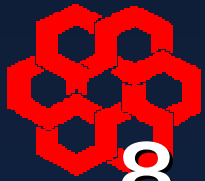
§ Lessor finance leases

§ Recoverable amount of goodwill



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:

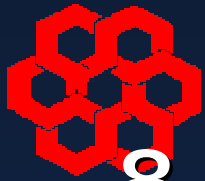
- Two classifications, not four
- Drop “continuing involvement approach” for derecognition
- Much simplified hedge accounting

§ Goodwill impairment – indicator approach

§ Expense all R&D

§ Cost method for associates and JVs

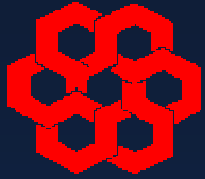
§ Income taxes – simplified method



IASB Approach

8. Recognition and measurement simplifications, page 2 of 2

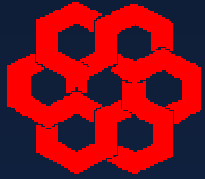
- § Less fair value for agriculture – only if “readily available” fair value
- § Defined benefit plans – principle approach, no corridor tests
- § Share-based payment – intrinsic value
- § First-time adoption – less prior data
- § Component depreciation not required



IASB Approach

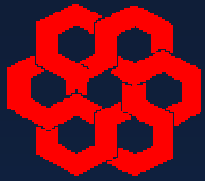
9. SME must try to find answers in SME standard by analogy and by using pervasive principles.
10. But – SME must look to full IFRSs as a “safety net” – if answer cannot be found otherwise.

§ Expected to be rare for typical SME.



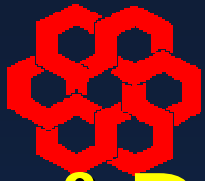
Other Issues

- § Suitability for micro-SMEs (tiny)?
- § Usefulness to managers of SMEs?
- § Usefulness for tax returns and dividend distribution?
- § Separate company statements?
- § Combined statement of income and retained earnings.



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.

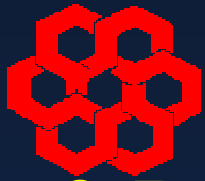
§ Public roundtables on R&M.

§ 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 – 7 meetings (so far)



The Result: Draft Exposure Draft

§ The draft ED now:

- § About 220 pages

 - § Full IFRSs now 2,400 pages.

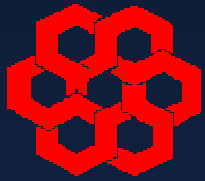
- § Organised by topic

- § 39 sections

- § Developed by considering needs of a company with about 50 employees

- § Model financial statements

- § Disclosure checklist



The Result: Draft Exposure Draft

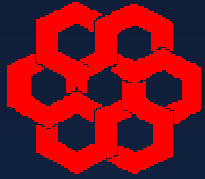
§ Very close to issuance.

§ Draft posted on IASB website in early August 2006 to:

§ Stimulate early thinking.

§ Allay concerns.

§ IASB will likely publish translations of ED in Spanish and possibly French as well. A first! German expected also.



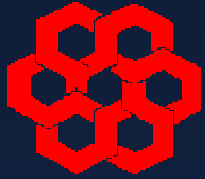
SME Concern: “Maintenance”

§ 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 – Q4 2006.

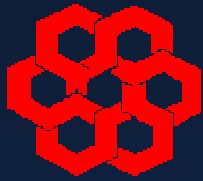
§ Six month comment period.

§ Time for translation.

§ Field tests and/or visits to SMEs? Roundtables?

§ Final Standard – 2007.

§ Effective – 2008 or 2009.



Thank you. Views of other panelists are next.

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.

