

Progress on the International Financial Reporting Standard for Small and Medium-sized Entities (SMEs) and convergence with UK GAAP, and the future development of the Charities SORP.

1. Introduction

- 1.1. The International Accounting Standards Board (IASB) issued a discussion paper entitled 'Preliminary Views on Accounting Standards for Small and Medium-sized Entities' in September 2004. Following the discussion paper, the IASB had undertaken to issue an Exposure Draft in late 2006.
- 1.2. The development of an SME standard, as part of the International Financial Reporting Standards (IFRSs) framework, is central to the development of the Charities SORP. **If the next SORP is to be drafted to meet the needs of smaller charities then an SME standard or an equivalent converged standard is central to that aim.**
- 1.3. This paper considers the nature of the background to the SME standard, the IASB intentions concerning the application of International Financial Reporting Standards (IFRSs) to not-for-profit entities and invites the Committee to consider and approve a letter to the IASB concerning accounting standards for not-for-profit entities.

2. The background to a SME Standard

- 2.1. The IASB has posted a project update concerning the SME standard on its website <http://www.iasb.co.uk/> for information only. A formal consultation will only be undertaken on an exposure draft once the IASB Board has considered and approved the text. The IASB initial intention was to publish the exposure draft by the end of 2006 with publication in January. Current IASB statements indicate that a final standard will be available in the second half of 2007.
- 2.2. The documents currently available from the IASB comprise the 2004 discussion paper entitled 'Preliminary Views on Accounting Standards for Small and Medium-sized Entities' published in 2004, the questionnaire published in 2005 requesting feedback on potential simplification, and an 'Illustrative Financial Statements and Disclosure Checklist Staff Draft of 2 November 2006' which provides a portrayal of how an SME's financial statements might look, but does not provide a detailed review of how IFRSs for an SME differs from full IFRSs.
- 2.3. The IASB plans for the exposure draft advise that the SME standard is intended for use only by small and medium-sized entities which do not have public accountability and publish general purpose financial statements for external users. External users are identified as owners not involved in managing the business, existing and potential creditors, customers and credit rating agencies.

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- 2.4. The IASB define public accountability as an entity which has filed, or is in the process of filing, financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market place, or an entity which holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank or similar entity. Public accountability is therefore equated with a responsibility to capital markets or a class of investors rather than a broader accountability to the public, society or beneficiaries.
- 2.5. The project overview updated by IASB on 2 August 2006 indicates that IASB will not develop guidelines on which entities should or should not be eligible to use the IASB Standard for SMEs and accepts this is a matter for local jurisdictions. Nevertheless, IASB have indicated they will indicate those entities for which the SME standard is not appropriate. We have previously indicated to the ASB that the Commission does not favour the generality of charities being included within the ambit of “publicly accountable entities” and the consequential full application of IFRSs.

Question:

Does the Committee agree that the generality of charities should be excluded from any future category of “publicly accountable entities?”

At what threshold, if any, should, in the view of the Committee, full IFRSs apply?

- 2.6. One of the purposes of the SME standard is ‘to reduce the financial reporting burden on SMEs that want to use global standards’. It should be noted that the SME standard will have to be adopted in full and only where a transaction occurs for which there is no treatment under the SME standard, can the entity treat that transaction in accordance with the relevant IFRS. A general awareness of the scope of the SME standard and full IFRSs would therefore be required by those preparing SME accounts. The SME standard is a commercial standard and would therefore require adaptation if used to inform the development of the next Charities SORP.
- 2.7. The ASB view on an SME standard, Inside Track issue 49, advised that the response favoured by far the majority of respondents to the ASB’s consultation was that there should only be two options – all companies should report under either IFRSs or the FRSSE. There should not be a third tier. In this way the UK version of the IASB’s proposed IFRS for SMEs could replace FRSSE, although these opinions are based on the assumption that the IFRS for SMEs would be an acceptable replacement

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for the FRSSE. The responses to the consultation broadly support a two-tier approach, with the lower level potentially (and ideally) being based on the outcome of the IASB's SME project.

- 2.8. The ASB's current line on convergence, Inside Track issue 49, is that the ASB has decided to defer any final decisions on convergence until there is a much clearer understanding of the outcome of the IASB project on SMEs, at which time a judgement can be made as to whether or not it is suitable for the UK's needs.

Question:

Does the Committee agree that a two tier approach is the appropriate way forward?

3. IFRS and not-for-profit entities

- 3.1. The IASB issued a discussion paper in 2006 entitled "Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information'. This conceptual framework document, developed by the IASB and US Financial Accounting Standards Board, seeks to establish the concepts that underlie financial reporting. The conceptual framework referred to the for-profit IFRSs and advised that: 'The boards decided to focus initially on business entities in the private sector. Once concepts for those entities are developed, the boards will consider the applicability of those concepts to financial reporting by other entities, such as not-for-profit entities in the private sector and, in some jurisdictions, business entities in the public sector.'
- 3.2. The work plan, checked as at 11 January 2007, which is published on the IASB website, sets out under the Conceptual Framework section, Phase G: Application to not-for-profit entities, with an intention to issue a discussion paper containing the IASB's preliminary views but it indicates no time scale.
- 3.3. The timing of this work creates a further risk factor as we develop the Charities SORP. If, for example, publication were delayed beyond the date targeted by ASB for convergence then the SORP Committee would need to develop its recommendations in the absence of the interpretative framework provide by the Conceptual Framework. The worst case scenario is that a new SORP is issued that conflicts with a subsequently published Application of the Conceptual Framework for not-for-profit entities.

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Questions:

Does the Committee support IASB's plan to develop an Application of the Conceptual Framework for not-for-profit entities?

Does the Committee anticipate this project limiting the role of the Charities SORP, or as providing a conceptual framework that should aid the SORP's development?

4. The work of the International Federation of Accountants (IFAC)

- 4.1. Under the auspices of IFAC, the International Public Sector Accounting Standards Board (IPSASB) is working on a project to apply IFRSs to the public sector, however the remit of IPSASB is 'on the accounting and financial reporting needs of national, regional, and local governments, related government agencies, and the constituencies they serve'.
- 4.2. IPSASB is seeking to develop an application of the conceptual framework for the public sector, however their brief is such that their interpretation would not provide a general not-for-profit solution. However their interpretative work on the application of IFRSs in a public sector context may be a useful resource in furthering the interpretative work of the SORP Committee as convergence with IFRSs progresses.

5. Conclusion and draft letter for consideration

- 5.1. The SORP Committee is invited to comment upon a draft letter to the IASB, which draws to the IASB's attention the implications of the convergence of UK GAAP with IFRSs for the charities SORP, and seeks a firm commitment from the IASB to address the needs of the not-for-profit sector.