CPA Uganda

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF UGANDA

Our Ref: STA/001

2 March 2023

The Chairman,
International Accounting Standards Board,
Columbus Building,
7 Westferry Circus,
Canary Wharf,
London E14 4HD,
United Kingdom.

Dear Sir,

THIRD EDITION OF THE IFRS for SMEs ACCOUNTING STANDARD

The Institute of Certified Public Accountants of Uganda (ICPAU) is pleased to participate in the second comprehensive review of the IFRS for SMEs Accounting Standard.

Our comments are restricted to the definition of public accountability and the proposed amendments to impairment of financial assets as detailed in **Appendix 1**.

We are hopeful that you will find them useful.

For any inquiries relating to this comment letter, kindly contact the undersigned at the email address: standards@icpau.co.ug

Yours faithfully,

CPA Charles Lutimba
MANAGER STANDARDS AND TECHNICAL SUPPORT
For: **SECRETARY/CEO**

Encl/⋯ (Appendix 1: ICPAU'S Responses to the Exposure Draft and Comment Letters: Third Edition of the IFRS for SMEs Accounting Standard)

NNN/⋯⋯.

Plot 42 Bukoto Street Kololo, P.O. Box 12464, Kampala | 0414 - 540125, 0393 - 262333 / 265590 / 266920 | icpau@icpau.co.ug | www.icpau.co.ug

APPENDIX 1: ICPAU'S RESPONSES TO THE EXPOSURE DRAFT AND COMMENT LETTERS: THIRD EDITION OF THE IFRS for SMEs ACCOUNTING STANDARD

Question 1–**Definition of public accountability**

Question 1 (i) Do you agree that the amendments will add clarity without changing the intended scope of the Standard? If you do not agree, which types of entities do you believe would be newly scoped in or scoped out?

Our Response:

Yes, we do agree that the amendments to paragraph 1.3(b) will add clarity without changing the intended scope of the IFRS for SMEs Accounting Standard. We believe that the deletion of the term 'most' is a welcome amendment as it exhibited confusion in interpretation in the past, that is, for one to believe most banks met the second criterion there should have been some empirical study performed. However, the deletion of the word '*woula*' seems to drive us back to a more certain conclusion than the Board may have envisioned (that is, that those institutions often meet the second criterion) especially without any empirical study. We believe using the phrase, "…would often meet this..." generally gives a better reference to the likely future outcome especially in the absence of any empirical study that would call for an absolute conclusion. Nevertheless, the assessment of the criteria is entity-specific, hence the proposed changes should not draw confusion.

Question 1(ii) Do you agree with the proposal to clarify the definition of public accountability? If you do not agree with the proposal, please explain what you suggest instead and why.

Our Response

We do not agree that the proposed paragraph 1.3A will help clarify the definition of public accountability. We are concerned that the proposed changes are likely to breed confusion instead. For example, while paragraph 1.3 seeks to apply the definition of public accountability by referring to paragraph 1.3(a), and if an entity does not satisfy this they seek reference to paragraph 1.3 (b), one wonders whether the proposals in paragraph 13A will not be considered as alternatives to application of paragraph 1.3.

In particular, will there be a hierarchy in applying the conditions, will the characteristics in paragraph 1.3A be used in addition to those in paragraph 1.3, is it envisioned that paragraph 1.3A conditions will always apply to entities scoped under

either paragraph 1.3(a) or paragraph 1.3(b), aren't the characteristics in paragraph 1.3A already implied in paragraph 1.3 e.t.c.
Further, the nexus between paragraphs 1.3 and 1.3A is unclear. While Paragraph BC17 of the Basis for Conclusions suggests that paragraph 1.3A is intended to clarify why the criterion in paragraph 1.3(b) is indicative of public accountability, we wonder why the IASB believes the characteristics in paragraph 1.3A should not be relevant to the criterion in paragraph 1.3(a) as well.

Other instances of confusion stem from the use of terms like; "high degree of outside interest," "substantial claim against the entity," and "broad group of users" which all seem to be subjective and therefore, prone to breeding a mixed interpretation on when the respective thresholds would be satisfied. We, therefore, propose that paragraph 1.3A be dropped. In the alternative, if it is to be retained, clarity needs to be given on how entities need to satisfy the criteria in paragraph 1.3 and paragraph 1.3A.

Additional Comments

The Standard seems to assert that all entities that do not have public accountability are SMEs. While this may partly be true, it does not fully represent the global economic environment especially for developing economies. The economies of many developing countries are dominated by entities that are characterized by an inability to use stock exchange markets, a high dependency on commercial banks to source funding, and a fluid distinction between ownership and management. For some of these entities, applying the requirements of the IFRS for SMEs Accounting Standard involves prohibitive expenses yet there is usually a requirement that such entities need to apply a recognizable framework if they are to access the much-needed funding.

In 2006 the International Federation of Accountants (IFAC) Small and Medium Practices (SMP) Committee Commissioned research on the then-proposed accounting standard for SMEs, the IFRS for SMEs. This was prompted by the fact that the intended framework was likely not to satisfy the needs of the smallest entities. In fact, Phase I of the research concluded that: "very little research had been previously conducted looking specifically at micro-entities as these tended to be subsumed in the term SME. That much of the published literature was restricted to studies conducted in developed countries and did not reflect the very different environment in which micro-entities operated in developing, emerging or transition economies." Upon this finding, Phase II of the research was commissioned and therein drew the following tentative conclusions;

(i) The proposed IFRS for SMEs (then) was too complex for micro entities;
(ii) It seems unlikely that simply making changes to the Exposure Draft would make it sufficiently suited to users and preparers of micro-entity financial reports; and
(iii) The case for a separate tier of accounting guidance for micro entities - received support at least from the respondents in the developing world.

In 2019, the Institute of Certified Public Accountants of Uganda (ICPAU) commissioned a study titled Enables and Inhibitors of IFRS for SMEs' Adoption in Uganda. The findings of the study amplified the need for a separate financial reporting framework for even smaller entities that have fewer information demands from external stakeholders, particularly, those with a more fluid distinction between ownership and management. The study found that such entities produced financial statements that were incomplete and untimely, rendering them uncompliant with the financial reporting framework that they purported to apply.

We are cognizant of the Board's tight schedules as per the work plan. We, however, recommend that a framework for micro entities be considered or in the alternative, and in the meantime, there be an introduction of an Exclusion Paragraph within the Scope of the SME Standard. P10 of the Standard allows jurisdictions to develop their definitions of SMEs based on the guidance in the Standard. We propose that the IASB enhances the requirements set out in P10 and P11 by adding an exclusion paragraph in the Scope of the Standard, as is the IASB's approach say to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets, and* other full IFRS Accounting Standards. We believe that this will further guide jurisdictions to develop their definitions of SMEs.

The introduction of an exclusion paragraph would establish a three-tier approach to the Scope of the IFRS for SMEs Accounting Standard. We note that entities in the first tier are known as publicly accountable entities while those in the second tier are known as SMEs. We propose that entities in the third tier be named "micro" entities and be defined as "*entities that produce financial statements intended for presentation to a limited group of users such as those required by a government entity for tax reporting or industry-specific reporting*". Micro entities would not be required to prepare general-purpose financial statements.

To guide jurisdictions on how to make the micro-SME classification, we propose that the IASB considers the inclusion of the following parameters:

- The greater the level of separation between management and owners or members that have an economic interest in an entity, the more likely the entity is required to prepare general-purpose financial statements.
- The more economic or political importance or influence an entity has, the more the entity is required to prepare general-purpose financial statements.
- The higher the level of sales/assets/debt/funding from governments or other external parties, the more likely the entity is required to prepare general-purpose financial statements.

Question 4–Proposed amendments to impairment of financial assets in Section 11 ***Basic Financial Instruments*** **(renamed** ***Financial Instruments*****)**

We take note of the proposed application of the expected credit loss (ECL) model on financial assets measured at amortised cost (other than trade receivables and contract assets). In Uganda, a number of SMEs do not possess sufficient historical data, such as credit-loss experience, either internally or from their sister groups for comparable financial instruments to ascertain appropriate credit loss rates. Also obtaining forward-looking information and an estimate of probability and related weight for formulating multiple forward-looking scenarios is likely to be problematic. Since SMEs usually have limited resources and expertise and given the observable challenges that larger entities have experienced in implementing the ECL under IFRS 9, we believe that the impairment model is likely to be complex and will likely pose significant challenges and difficulties for SMEs. The ultimate hurdle in view of the above challenges is likely to be the quality of impairment information provided by SMEs using the ECL model; SME will be able to deliver reliable information, a key qualitative characteristic of information in financial statements as envisaged in the concepts and perversive principles' section of the Standard.

The above notwithstanding, the Board may consider providing practical expedients that SMEs can apply in measuring ECL and key considerations in ECL modelling.