

## IESBA SME/SMP Working Group

### Background

IFAC's mission is to serve the public interest, continue to strengthen the accountancy profession worldwide, contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the convergence of such standards, and speaking out on public interest issues where the profession's expertise is most relevant. The IESBA contributes to the success of this mission by developing and issuing high quality ethical standards and other pronouncements for professional accountants for use around the world. The IESBA's Code of Ethics establishes ethical requirements for professional accountants.<sup>1</sup>

Small- and medium-sized entities ("SMEs") are an important contributor to the world's economies. SMEs, which are characterized as non-public interest entities ("non-PIEs") (see Appendix II), far outnumber entities currently characterized as public interest entities. In order to better serve the public interest, the Board recognizes the importance of understanding the issues involving the application of the Code by professional accountants in SMEs and professional accountants in public practice, including SMPs, providing services to SMEs.

One of the objectives of IFAC's Small and Medium Practices ("SMP") Committee is to directly work with IFAC standard-setting boards, and other standard setting bodies to ensure that they are aware of and give consideration to issues relevant to SMEs/SMPs. As such, the SMP Committee is available to help the Board gain insights into SMEs and accountants in public practice providing services to SMEs. The SMP Committee represents the interests of professional accountants operating in small- and medium-sized practices and other professional accountants who provide services to SMEs (see Appendix III).

The IESBA has obtained input from the SMP Committee in the past, and included a specific question to elicit feedback on issues of relevance to SMEs and SMPs in its *Strategy and Work Plan 2010-2012 Exposure Draft*. Respondents to the *Exposure Draft* highlighted the importance of the Board focusing its attention on the needs of SMPs and SMEs. This is consistent with the views of respondents to the 2009 Global Leadership Survey, who identified addressing the needs of SMEs and SMPs as one of the most important issues facing the accounting profession.

Following through on this strategy and work plan, the IESBA Planning Committee has recommended the formation of an IESBA SME/SMP Working Group to advise the Board on how it can best facilitate the application of the Code by professional accountants in SMEs and professional accountants in public practice, including SMPs, providing services to SMEs.

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<sup>1</sup> Handbook of the Code of Ethics for Professional Accountants, 2010 edition, preface

**Preliminary plan** (see Appendix IV for a preliminary timetable)

A draft Terms of Reference (see Appendix I) has been provided for consideration by the Board. The Board's input will be discussed by the Working Group and a final Terms of Reference will be submitted to the Board for approval in February. It is anticipated that the Working Group will proceed with its work based on the Board's clearance to the Working Group in November 2010. The Working Group will identify matters warranting attention based on each member's knowledge, relevant information available within IFAC, input from IFAC member organizations and others at an SMP Forum to be held in March, and additional input as needed. There will be communication with representatives of both the SMP Committee and the Professional Accountants in Business Committee.

Taking into account matters identified as warranting attention, the Working Group will consider how the Board may facilitate the application of the Code by professional accountants in SMEs and professional accountants in public practice providing services to SMEs. The Working Group will focus on practical recommendations that serve the public interest, reinforce the importance of high quality ethical standards, and address unique and challenging issues faced by SMPs and SMEs in complying with the Code.

**Reporting to the Board**

The Working Group will provide a report to the Board setting out matters that in its view should be brought to the Board's attention. These are expected to include information that will enhance the Board's understanding of the unique and challenging issues that SMPs and SMEs face in applying the Code.

The Working Group's mandate does not include issues related to adoption of the Code in particular jurisdictions. However, its work may enhance the Board's understanding of such issues.

Some matters reported to the Board may best be addressed by a body other than the Board. For example, translation and education issues may be addressed in whole or in part by another IFAC body.

Recommendations may include:

- The development of non-authoritative guidance to assist professional accountants in public practice, including SMPs, with the consistent application of the Code when providing services to SME audit clients, for example:
  - Analysis of restrictions limiting non-assurance services;
  - Analysis of safeguards available to manage independence threats created by non-assurance services;
  - Case studies;
  - Training materials.
- Revisions to the Code, if warranted.

**Action Requested**

1. IESBA members are asked to approve the formation of the Working Group.
2. IESBA members are asked to provide advice on the Working Group's draft Terms of Reference and other matters.

## **Appendix I - IESBA SME/SMP Working Group Draft Terms of Reference**

### **1.0 Objective**

The IESBA has been advised that SMEs and SMPs face unique and challenging issues in complying with the Code, particularly with respect to SMPs serving SMEs. The Working Group's objective is to determine what those issues are, understand them, and recommend to the IESBA ways in which the board might address them.

### **2.0 Approach**

The Working Group will develop and validate findings and recommendations based on research and communication with those who understand the issues. Timely reporting to the IESBA will be important to enable the IESBA itself to be suitably responsive.

### **3.0 Deliverables**

The Working Group is responsible for reporting its findings and recommendations to the IESBA. Recommendations should be consistent with the importance of SMPs and SMEs serving the public interest, reinforce the importance of high quality ethical standards, including independence standards, for professional accountants in public practice and in business and, where feasible, offer practical solutions to the unique and challenging issues faced by SMPs and SMEs in complying with the Code.

### **4.0 Composition**

The Working Group will be chaired by a member of the IESBA, with 6-7 additional members, including 2 IESBA technical advisors and 4 individuals from the SME/SMP community. A seventh additional member may be appointed from a developing nation.

## Appendix II - SMEs

Based on the definition and description set out below, the Working Group will characterize SMEs as non-PIEs.

The Working Group has for reference the International Accounting Standards Board (“IASB”) definition of an SME:

“Small and medium-sized entities are entities that:

- (a) do not have public accountability and
- (b) publish general purpose financial statements”<sup>2</sup>

Also, the SMP Committee has concluded that:

“...the determination of whether an entity is an SME should be driven by a combination of quantitative and qualitative characteristics.

“The SMP Committee believes quantitative characteristics are best determined at jurisdiction level. What is considered small in the US would be considered large in many less developed and smaller economies. However, the primary qualitative characteristic should be whether or not the entity, in its own right, falls within the definition of ... non-public-interest entities (NPIE) as per the IESBA’s definition under its New Code.

“In addition, other qualitative factors can help distinguish an SME including *one or more* of the following:

- Fewer lines of business and fewer products within lines;
- Concentration of marketing focus, by channel or geography;
- Leadership by management with significant ownership interest or rights;
- Fewer levels of management with wider spans of control;
- Less complex transaction processing systems and control;
- Fewer personnel, many having a wider range of duties; and
- Limited ability to maintain deep resources in line and support positions such as legal, human resources, accounting and internal auditing.”<sup>3</sup>

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<sup>2</sup> International Financial Reporting Standard for Small and Medium-Sized Entities (“IFRS for SMEs”), paragraph 1.2

<sup>3</sup> Background Information Paper, SMP Review Task Force appointed by the PFC to determine how IFAC can best support SMPs, 2009, paragraphs 3.3 to 3.5

### **Appendix III - The SMP Committee and SMPs**

The SMP Committee has commented on the scope of its constituency and the characteristics of an SMP:

“The broad client-based way that the [SMP Committee] Terms of Reference defines the committee’s constituents means that even a large practice could be interpreted as a constituent of the SMP Committee in so far as they provide accounting and assurance services to SMEs. Indeed, practices of all sizes are faced with the problem of the application of international standards of auditing, assurance, accounting and ethics to SME clients. For similar reasons to those mentioned above for SMEs, the SMP Committee sees little case for a precise global definition for SMPs. That said as with SMEs we do believe in having some general guiding principles to help determine what constitutes an SMP. An SMP is a small business and so some of the SME criteria outlined above may apply to SMPs. In addition, an SMP will demonstrate *one or more* of the following attributes:

- Most of its clients are SMEs and it ordinarily does not have PIE clients;
- External sources used to supplement limited in-house technical resources;
- Majority of client work may be non-assurance services;
- Limited number of professional staff; and
- Less formal quality control procedures.”<sup>4</sup>

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<sup>4</sup> Background Information Paper, SMP Review Task Force appointed by the PFC to determine how IFAC can best support SMPs, 2009, paragraph 3.6

#### **Appendix IV - IESBA SME/SMP Working Group Preliminary Timetable**

Set out below is a preliminary Working Group timetable:

October 2010	IESBA Planning Committee - Consider the draft Terms of Reference and support for the formation of the Working Group.
November 2010	IESBA - Consider the draft Terms of Reference and approve the formation of the Working Group.  IESBA Planning Committee - Approve the Working Group member appointments.
Oct-Dec 2010	Gather, compile and circulate initial information, including: <ul style="list-style-type: none"><li>• A summary of any relevant information currently in the Board's files or available from other IFAC bodies dealing with member body compliance with the Code, with particular focus on any known areas of concern related to application of the non-PIE provisions of the Code; and</li><li>• A summary of any other relevant information currently in the Board's files or available from other IFAC bodies, such as relevant reports and responses to exposure drafts and surveys and other available IFAC resources.</li></ul>
January 2011	Working Group (face-to-face meeting) - Consider the Terms of Reference and a preliminary plan, including initial identification of matters warranting attention.
February 2011	IESBA - Receive a status report and approve the Terms of Reference.  Working Group (conference call) – Prepare for the SMP Forum in Istanbul and continue discussion of issues.
March 2011	SMP Forum (Istanbul) - Solicit input to the Working Group and exchange ideas with representatives from IFAC member bodies and other organizations on the issues facing SMEs and SMPs.  Working Group (meeting in Istanbul) - Consider insights from the SMP Forum and discuss the non-PIE provisions of the IFAC Code, focusing in particular on matters identified as warranting attention.
May 2011	Working Group (conference call) – Continue discussion of matters warranting attention and the Working Group's preliminary report

- June 2011                    IESBA – Receive and discuss the Working Group’s preliminary report
- Working Group (face-to-face meeting, if needed, probably in the same location as the Board meeting or the SMP Committee meeting) – Continue discussion of matters warranting attention and the Working Group’s final report
- August 2011                Working Group (conference call) – Continue discussion of matters warranting attention and the Working Group’s final report
- October 2011                IESBA – Receive the Working Group’s final report and consider the Board’s response to any recommendations.