

December 5th, 2011

Paul Druckman
CEO
International Integrated Reporting Council

Dear Paul,

Re: The IIRC's Discussion Paper, Towards Integrated Reporting

The Small and Medium Practices (SMP) Committee of the International Federation of Accountants (IFAC) values the opportunity to provide comments to you on the Discussion Paper proposing the development of an Integrated Reporting Framework. In responding, the SMP Committee has focused purely on the question of most relevance to its constituents, Question 4. Many SMEs rely on small practices to prepare their financial statements and we believe this will also be the case for Integrated Reporting (IR). The SMP Committee is supportive of this project and offers comments that it hopes will help ensure that an eventual IR Framework will be capable of being readily applied to SMEs. Our comments in relation to Question 4 follow.

Question 4 (a) Do you agree that the initial focus of Integrated Reporting should be on reporting by larger companies and on the needs of their investors? Why/why not? (b) Do you agree that the concepts underlying Integrated Reporting will be equally applicable to small and medium enterprises, the public sector and not-for-profit organizations?

We have a general concern that whenever international regulators and standard setters set about developing policy, regulation and standards there seems to be a tendency to consider large listed entities with international reach in the first instance. Subsequently, as regulators have gotten to appreciate the benefits of convergence for all entities, they have been inclined to pursue a 'one size fits all approach' and accordingly cascade down requirements to SMEs. The result has sometimes been the imposition of ill-suited regulation and standards, in terms of relevance and magnitude of burden, on SMEs. Hence, when developing policy and regulation it is vital for the sake of equity and efficiency that one carefully considers the suitability of the proposed policy or regulation to the entire population of entities that might one day be subject to the same regulation. We would expect that SMEs would not be required to produce an IR but rather encouraged to do so.

We note the IIRC is proposing an investor focus rather than taking a wider stakeholder view. The potential advantage of the latter perspective is that this approach might make the framework more relevant for SMEs, many of which are owner-managed and/or owned by a family. This is especially important given that globally SMEs account for the majority of private sector GDP, wealth and employment creation, social impacts and carbon footprint.

In order to address these concerns we suggest that either the IIRC consider adopting a 'think all first' approach, which would entail the determination of a minimum set of requirements that would be applied



to all entities and then establishing a set of additional requirements for larger listed companies. We feel that this approach will ensure that the IR Framework is scalable and relevant to SMEs. We recognize that this may necessitate some re-engineering of the project. However, the present investor/large listed entity focus has potential drawbacks as explained below (while these remarks relate to unlisted entities, similar arguments may apply for smaller listed companies).

First, the general experience noted above whereby regulation and standards that were originally designed and fashioned for larger listed entities get cascaded down to SMEs. IFRS is often cited as an example of this. While developed only with capital markets and listed entities in mind, national and regional regulators started to impose its use on all companies irrespective of size, complexity and public interest/accountability. In the face of concerns over the complexity of IFRS and the resulting burden of preparation, concern over its lack of relevance to SMEs and their users, and a growing appetite to have international convergence for SME financial reporting, the IASB conceded to pursue a differential approach culminating in the IFRS for SMEs. The development of the IFRS for SMEs proved especially difficult. The IASB decided that it would be a stand-alone derivative of IFRS with accounting principles based on existing IFRS but simplified to suit SMEs. As the IASB set about simplifying existing IFRS it met resistance, the onus tending to be placed on those advocating simplifications to provide robust justifications for them. Some argue that the outcome is a standard that is too complex for very small entities and, being derived from full IFRS, not sufficiently tailored to the needs of users of SME financial statements. Indeed recent research conducted by the European Commission suggests that well established reporting requirements that were developed for larger listed entities and then simplified for SMEs may not adequately meet the information needs of users of SMEs¹. With the benefit of hindsight the IASB might have considered all entities when it first developed IAS/IFRS, and developed one standard suitable for all with additional requirements and guidance for the benefit of larger listed entities.

Second, it is likely that even if one did not require SMEs to do IR through regulation, market pressure through the supply chain will likely result in larger listed entities requiring their SME suppliers to conduct some form of IR themselves as a condition of doing business in order that they may fulfill their own IR obligations. We have seen this happen with ISO 14001 and sustainability and CSR reporting more generally. Indeed, larger firms may demand that their SME suppliers meet the same information obligations as their large firm customers. This may impose a disproportionate burden on SMEs, increasing their costs and placing them at a market disadvantage.

Third, during a time of heightened concern over 'red tape' and burden of regulation on SMEs, as stressed by the findings from our SMP Quick Poll², there is a risk that additional reporting requirements will not be welcome, no matter their merits. Consequently, it is vital that that one can readily demonstrate that any additional reporting requirements will likely yield benefits to SMEs and to their key stakeholders such as owners, customers, employees, suppliers and creditors in the shape of better business decisions, that exceed the costs of implementing these requirements.

¹ See http://ec.europa.eu/enterprise/policies/sme/business-environment/files/study_on_accounting_requirements_for_smes_final_report_en.pdf

² See <http://www.ifac.org/news-events/2011-10/smp-quick-poll-reveals-increased-optimism-among-small-practices>



Fourth, ceteris paribus SMEs are likely to report less well than larger companies due to the absence of intense public scrutiny and of in-house reporting expertise. An IR Framework that applies to all size of entity should promote better IR reporting by SMEs.

Finally, an all embracing IR Framework will make it easier for SMEs that develop into larger listed entities as they will simply have to scale-up their existing IR rather than implement it from first principles.

If the IIRC is not convinced of the need for a 'think all first' approach as outlined above then we would strongly encourage the IIRC to plan, on a timely basis, for a differential IR reporting regime. This planning will necessitate ensuring that the framework is based upon a set of core principles that are sufficiently generic and high level that they could serve as the basis for the development of IR requirements tailored to SMEs while ensuring compatibility with those applicable for larger listed entities. As noted above the supply chain will result in many SMEs being impacted by IR even if they are not subject to direct regulation.

Regardless of whether the IIRC adopts a 'think all first' approach or plans for differential regime we feel it essential that the IIRC ensures participation of SMEs in its Pilot Programme. We note from the list of current participants³ that the vast majority appear to be large listed entities and a minority medium sized according to European Union classification criteria. While we understand the difficulty in obtaining the participation of SMEs, which are often less engaged with the development of international regulation and standards as larger listed entities and concerned at the extent of resources required to participate, we feel their participation is crucial to ascertaining whether the framework is sufficiently scalable and relevant to SME stakeholders as to ensure an advantageous cost-benefit outcome for SMEs. Hence, we suggest the IIRC seriously consider lowering the cost of participation to encourage SMEs to apply. As things stand companies with turnover of more than GBP 600 million pay GBP 10,000 to join the programme while those with less may opt to contribute less, down to GBP 5,000, meaning a disproportionate burden on SMEs and as such a barrier to their participation; a percentage of turnover might be a better way of determining the contribution. In addition, the IIRC may need to consider other ways of encouraging the participation of SMEs, possibly via increased awareness raising activities.

Please do not hesitate to contact me should you wish to discuss any of the matters raised in this letter. We also welcome further discussions on how the SMP Committee can support the work of the IIRC.

Kind regards,

A handwritten signature in black ink, appearing to read 'Sylvie Voghel', with a light blue circular stamp behind it.

Sylvie Voghel

³ See <http://www.theiirc.org/2011/10/26/iirc-announces-selection-of-global-companies-to-lead-unique-integrated-reporting-pilot-programme/>



Chair, IFAC SMP Committee