

14 October 2004

Sir David Tweedie
Chairman IASB
30 Cannon Street
London EC4M 6XH
UK

CL 113

Dear David,

Re: Discussion Paper: Preliminary Views on Accounting Standards for Small and Medium-sized Entities

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Discussion Paper "Preliminary Views on Accounting Standards for Small and Medium-sized Entities". This letter is submitted in EFRAG's capacity of contributing to IASB's due process.

We welcome the Board's decision to develop a separate set of financial reporting standards for SMEs as we see this as an opportunity to further harmonise accounting standards in Europe and globally. As explained in detail in our responses to the questions raised in the Discussion Paper in the appendix to this letter, we have the concerns mentioned below.

We do not support the public accountability principle as the dividing line between entities complying with full IFRS and those to comply with IFRS for SMEs. We believe that only listed entities should be formally excluded by IASB from the scope of IFRS for SMEs. Further restrictions to the scope of applicability of IFRS for SMEs should remain the sole responsibility of the appropriate level of jurisdiction. We therefore recommend the Board to rename the standards to "IFRS for unlisted entities".

We believe an analysis of the specific users' needs should be performed to determine if and how they differ from users' needs for listed companies.

The appropriate Framework for SMEs can in our opinion first be considered, when the Board has finalized its analysis of the user needs. However, we believe that the Framework to be applied for SMEs can be based on the same principles as in the present IFRS Framework, although it may have to be adapted to accommodate the characteristics of SMEs.

Because the users' needs are not discussed in the IASB discussion paper we have not been able to draw final conclusions on the likely extent of changes to disclosure and presentation (Q7b) and recognition and measurement for SMEs (Q7c).

We acknowledge the current work pressures on the Board. We therefore suggest the establishment of a permanent working committee actively involved in the SME project to

support and relieve the pressure from the Board. The members of this committee should be selected by the Board and be advisory only.

If you would like further clarification of the points raised in this letter Paul Rutteman or myself would be happy to discuss these further with you.

Yours sincerely,

Stig Enevoldsen
EFRAG, Chairman

Issue 1: Should the International Accounting Standards Board (IASB) develop special financial reporting standards for SMEs?

Question 1a. Do you agree that full IFRSs should be considered suitable for all entities? If not, why not?

Response:

We agree that IFRSs in principle are suitable for all entities including SMEs when the objectives of general purpose financial statements are fundamentally the same for all entities. However, the suitability of IFRSs for SMEs depends on whether the resulting financial statements meet users' needs. We believe that the preparers' need for accounting standards easing the burden should also be taken into consideration. If the users in the context of SMEs appear to require less sophisticated or less comprehensive information or simply have requirements different from in an investors' world of publicly listed entities using full IFRS, then the IASB standards for SMEs may need to differ from IFRSs.

Question 1b. Do you agree that the Board should develop a separate set of financial reporting standards suitable for SMEs? If not, why not?

Response:

We welcome the Board's decision to develop a separate set of financial reporting standards for SMEs. At present many different national standards for SMEs are being or have been developed in Europe. We see the IASB project as a chance to harmonise accounting standards and to achieve over time, as national jurisdictions determine, comparability of financial statements among entities within Europe and globally. Adoption of a common set of accounting standards is an important objective for SME financial reporting.

We believe that, as suggested by the Board, IASB standards for SMEs should be designed on the basis of users' needs. We therefore suggest that first a thorough appraisal of users' needs should be prepared, in the context of SMEs. Only then will it be possible to ascertain to what extent present IFRSs do not meet the users' needs of SME financial statements.

The main target of full IFRS is the investors' world of publicly listed entities. Investors need financial information to analyse and conclude whether to buy, hold or sell their equity investments in short term. For this purpose they need detailed financial information to prepare an indicative valuation of the entity. The number of shareholders in SMEs are in most cases limited compared to publicly listed entities and their investment is usually far longer term. Their most frequent use of financial information is not usually to determine whether to make an immediate buy, hold or sell decision.

Without anticipating the outcome of the necessary analysis, we believe that users in an SME environment might require less complex and less sophisticated financial information and that SME financial statements users are primarily interested in being able to:

- assess stewardship or accountability of management;
- consider the ability of the enterprise to pay and provide other benefits to its employees, to meet its obligations towards lenders, creditors and customers by focusing more on liquidity and solvency than on the present value of the entity, and
- determine distributable profits and dividends.

A separate set of standards for SMEs should not only focus on the users' needs, but also take into account the ability of each user category to access financial information beyond statutory financial statements. However, we recognise that financial statements cannot fully meet all users' needs at any time. They are general purpose financial statements.

Question 1c. Do you agree that IASB Standards for SMEs should not be used by publicly listed entities (or any other entities not specifically intended by the Board), even if national

law or regulation were to permit this? Do you also agree that if the IASB Standards for SMEs are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs? If not, why not?

Response:

To ensure consistency, we believe that IASB should formulate as clearly as possible the Board's working definition of SMEs for which the SME standards are intended. Such working definition can be used by the appropriate jurisdiction as guidance. However, it is not the IASB's responsibility to ensure that use of IFRS for SMEs is restricted to that defined group of SMEs. This relies solely on the requirements being set by the appropriate level of jurisdiction.

Issue 2: What should be the objectives of a set of financial reporting standards for SMEs?

Question 2. Are the objectives of IASB Standards for SMEs as set out in preliminary view 2 appropriate and, if not, how should they be modified?

Response:

In general we agree with the objectives as set out in preliminary view 2, although we have some observations in relation to objectives (c) and (e).

Objective (c); be based on the same conceptual Framework as IFRSs

In our opinion, the appropriate Framework for SMEs can first be considered only when the Board has finalized its analysis of the users' needs. However, we believe that the Framework to be applied for SMEs can be based on the same principles as the present IFRS Framework, although it may have to be adapted to accommodate the characteristics of SMEs.

In our opinion a clear identification of users and users' needs and a clear IASB definition of the range of entities for which IASB Board intended the IASB standards for SMEs should be stated either in the Framework applicable for SMEs or in a preface to the SME standards.

- The reasons for issuing specific ASB standards for SMEs including a related Framework should be addressed;
- the criteria used to transpose IFRS into IFRS for SMEs should be stated in the applicable Framework or preface;
- if a separate SME Framework is developed the descriptions should be less detailed and more focused on SMEs and the examples would need to be removed or adapted compared to the present IFRS Framework;
- if no separate SME Framework is developed the present IFRS Framework could be used with the paragraphs expanded to deal with SME issues where necessary;
- any future amendments to the existing IFRS Framework should not be presumed applicable to SMEs without a proper analysis in the light of those guiding principles; and
- comparability over time may be more relevant for SMEs than comparability between businesses. It remains essential that similar transactions are treated in a similar way.

Objective (e): allow easy transition to full IFRSs for those SMEs that become publicly accountable or choose to switch to full IFRSs

We do not consider allowing easy transition to full IFRSs as one of the objectives in setting IFRS for SMEs. It is indeed likely that the vast majority of SMEs will never move to full IFRS. Having easy transition to full IFRS as an objective would in our opinion involve unnecessary supplementary constraints and could result in a set of standards that might not be as close to users' needs as feasible.

Issue 3: For which entities would IASB Standards for SMEs be intended?

Question 3a. Do you agree that the Board should describe the characteristics of the entities for which it intends the standards but that those characteristics should not prescribe quantitative 'size tests'? If not, why not, and how would an appropriate size test be developed?

Response:

We agree that the Board should describe the characteristics of the entities for which it intends the standards to be applicable and that those characteristics should not prescribe quantitative size tests. We agree with the Board that it is not feasible to develop a quantified size test that would be applicable and long-lasting in all countries.

Furthermore we agree that it should be left to the appropriate level of jurisdictions to determine whether all entities that meet those characteristics, or only some, should be required or permitted to use IFRS for SMEs.

Question 3b. Do you agree that the Board should develop standards that would be suitable for all entities that do not have public accountability and should not focus only on some entities that do not have public accountability, such as only the relatively larger ones or only the relatively smaller ones? If not, why not?

Response:

It should be left to the appropriate jurisdiction to decide the scope of the use of IFRS for SMEs. However, as mentioned in Q1c we believe that the Board may issue its working definition as guidance to the appropriate jurisdictions. This guidance will help the jurisdictions to appropriately set the scope of application of IFRS for SMEs.

Moreover, we do not believe that any focus in relation to the size of the entity would be relevant. Very large or complex entities might enter into transactions that require the level of sophisticated financial reporting as required by full IFRS and would therefore logically not fall in the scope of IFRS for SMEs. At the other end of the scale, the benefits of worldwide accepted accounting standards are likely to be of minimal use to very small entities and therefore jurisdictions would be justified in deciding to scope them out.

Question 3c. Do the two principles in preliminary view 3.2, combined with the presumptive indicators of 'public accountability' in preliminary view 3.3, provide a workable definition and appropriate guidance for applying the concept of 'public accountability'? If not, how would you change them?

Response:

We have our doubts in relation to the public accountability approach as defined and explained through criteria a) to d) as we do not believe that such a definition without a size criterion, can serve as the universal definition of the scope of IFRS for SMEs. The definition of the adequate scope of IFRS for SMEs is, in our view the sole responsibility of the appropriate level of jurisdiction as particular local circumstances may vary and therefore justify adaption of the scope. Examples of situations that may require local adjustments include:

- entities that meet the IASB public accountability definition but which are of a size incompatible with the burden of full IFRS,
- publicly accountable institutions, such as banks, insurance or public utilities. They may be placed under the control of regulating agencies responsible for assessing the credit worthiness of those institutions and these regulating agencies have the power to obtain comprehensive and sophisticated financial reporting beyond information contained in the financial statements, if and when required, and their role in relation to safeguarding the interests of users of financial statements may be proportionately greater than it is in relation to publicly listed companies,
- in some areas in the world, local jurisdictions may forbid the conversion to full IFRS for non-publicly listed companies yet be prepared to adopt IFRS for SMEs, which may embody significant improvements compared with their current reporting requirements.

Moreover the economic significance criterion may result in IFRS for SMEs being inconsistently applied in different jurisdictions.

We believe that only listed companies should be formally excluded from the scope of IFRS for SMEs. Further restrictions to the scope of applicability of IFRS for SMEs should as mentioned above remain the sole responsibility of the appropriate level of jurisdiction. However, it should be possible for jurisdictions to accept the IASB's working definition as the final scope.

Question 3d. Do you agree that an entity should be required to use full IFRSs if one or more of the owners of its shares object to the entity's preparing its financial statements on the basis of IASB Standards for SMEs. If not, why not?

Response:

We do not agree that an entity should be required to use full IFRSs if one or more of the shareholders object to the entity's preparing its financial statements on the basis of IASB standards for SMEs. We believe that this question should be left to the appropriate level of jurisdictions to decide. It is not an accounting issue, but a company law issue within the jurisdiction concerned.

Question 3e. Do you agree that if a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements of its parent, venturer or investor, the entity should comply with full IFRSs, and not IASB Standards for SMEs, in its separate financial statements? If not, why not?

Response:

We believe that this is a matter for the group and the relevant national jurisdiction to determine. We do not believe that a subsidiary, joint venture or associate of an entity with public accountability, which prepares financial information in accordance with IFRSs, should comply necessarily with IFRSs in its separate financial statements. In our view, the greatest benefit of IASB standards for SMEs is to increase the relevance of financial reporting to the users of SME financial reporting. We therefore believe that an entity may provide to the users of its separate accounts a relevant set of accounts prepared in accordance with IASB standards for SMEs while providing its parent with the level of information needed for consolidated accounts to be prepared in accordance with IFRS.

Moreover the level of materiality to be applied to consolidated accounts may differ from the level of materiality applicable to the individual accounts.

Issue 4: If IASB Standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, how should that entity resolve the issue?

Question 4. Do you agree that if IASB Standards for SMEs do not address a particular accounting recognition or measurement issue, the entity should be required to look to the appropriate IFRS to resolve that particular issue? If not, why not, and what alternative would you propose?

Response:

In our view, the scope of the fallback to IFRSs should be limited to a few specific circumstances identified in IFRS for SME. IASB standards for SMEs should be obligatory for the remainder of its financial statements. The use of the fallback should be disclosed in the note providing detailed information about accounting policies applied.

Each SME standard should explicitly mention in which situations fallback is mandatory with reference to the specific IFRS. If there is no fallback paragraph in the SME standard, the preparer should solve the recognition or measurement issue by using the same hierarchy as in the present IAS 8 paragraph 10-12.

Issue 5: May an entity using IASB Standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB Standard for SMEs?

Question 5a. Should an SME be permitted to revert to an IFRS if the treatment in the SME version of the IFRS differs from the treatment in the IFRS, or should an SME be required to choose only either the complete set of IFRSs or the complete set of SME standards with no optional reversion to individual IFRSs? Why?

Response:

Unless it is impossible to give a fair presentation by means of the SME version of an IFRS, no reversion should be permitted in the IASB standards for SMEs, since an entity has to comply with the full set of standards, either IFRS or IASB standards for SMEs. We believe that when a set of standards is based on a Framework related to the users' needs, entities should not have the option to choose between the two different sets of standards.

Additional disclosures should of course always be permitted if relevant for the understanding of the financial statements. If reversion to an IFRS is required on the grounds of fair presentation, full disclosure of the circumstances and effect should be given as required in IAS 1.

Furthermore we are concerned about the issue of what set of standards should be referred to in the accounting policies and in the audit report in the absence of application of one comprehensive set of standards.

Question 5b. If an SME is permitted to revert to an IFRS, should it be:

- (a) required to revert to the IFRS in its entirety (a standard by standard approach);**
- (b) permitted to revert to individual principles in the IFRS without restriction while continuing to follow the remainder of the SME version of the IFRS (a principle by principle approach); or**
- (c) required to revert to all of the principles in the IFRS that are related to the treatment in the SME version of that IFRS while continuing to follow the remainder of the SME version of the IFRS (a middle ground between a standard by standard and principle by principle approach)?**

Please explain your reasoning and, if you favour (c), what criteria do you propose for defining 'related' principles?

Response:

This question is not applicable in respect of our answer to Q5a.

Issue 6. How should the Board approach the development of IASB Standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?

Question 6. Do you agree that development of IASB Standards for SMEs should start by extracting the fundamental concepts from the Framework and the principles and related mandatory guidance from IFRSs (including Interpretations), and then making modifications deemed appropriate? If not, what approach would you follow?

Response:

We agree that IFRS may be the starting point in the development of IASB Standards for SMEs because that approach is most likely to avoid the introduction of differences from full IFRS that reflect personal preferences rather than identified needs of users of SME financial statements. From a pragmatic standpoint, it is easier and less costly to identify differences from IFRS than to start from a blank sheet. Proceeding by extraction of the fundamental concepts from the Framework and by adjustment to the principles and related mandatory guidance from IFRSs seems therefore appropriate. In order to confirm that this produces the most appropriate standards we suggest that the following steps should also be undertaken:

- a clear IASB working definition of entities for which the SME standards are intended, (even if it must be left to the appropriate jurisdictions to make the final definition of the scope of the SME standards).

- analysis of specific users' needs and how they differ from the needs of users best served by IFRS,
- definition of the Framework applicable for SMEs and if it is decided that there is no Framework specific to SMEs, definition of a preface that would present the rationale used for setting a separate set of accounting standards for SMEs and differentiating them from IFRS
- only then it can be confirmed that modifications and additions made to IFRS are suitable for SMEs.

Standards, or parts of standards, which are not of high relevance for SMEs, if any, should be left out of the scope of standards for SMEs.

Clear criteria should be provided to transpose IFRS into IASB standards for SMEs. Analyses on the extracted standards should be conducted: both, changed and retained requirements should be justified in the Basis for Conclusions standard by standard, based on users' needs.

Interpretations should normally not be modified but their relevance to SMEs should be considered individually.

Adjusting the fundamental concepts and principles from the IFRS should not result in the elimination of all illustrations and guidance. "Bare" principles would indeed be difficult to apply or leave so much room for interpretation that, either consistency with IFRS and comparability would never be achieved, or fallbacks to IFRS guidance would be needed throughout. The necessary illustrations and guidance will have to be drafted or adjusted very carefully.

Issue 7: If IASB Standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?

Question 7a. Do you agree that any modifications for SMEs to the concepts or principles in full IFRSs must be on the basis of the identified needs of users of SME financial statements or cost benefit analyses? If not, what alternative bases for modifications would you propose, and why? And if so, do you have suggestions about how the Board might analyse the costs and benefits of IFRSs in an SME context?

Response:

We do agree that any modifications for SMEs to the concepts or principles in IFRS must be based on the identified needs of users of SME financial statements together with a cost benefit analysis thus taking the preparers' needs into consideration.

When modifying the concept of disclosure and presentation, clear connection between recognition and measurement and the modified disclosure should be ensured.

In our opinion it is not useful to start modifying IFRS before the users' needs are clearly defined and the Framework applicable for SMEs is determined, and both have been exposed for public comment.

Question 7b. Do you agree that it is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost benefit analyses and that the disclosure modifications could increase or decrease the current level of disclosure for SMEs? If not, why not?

Response:

As extensive analysis of users' needs are not part of this discussion paper we are not able to prejudge the outcome of these, but we expect that disclosure and presentation requirements will decrease in the SME standards compared to IFRS.

Question 7c. Do you agree that, in developing standards for SMEs, the Board should presume that no modification would be made to the recognition or measurement principles

in IFRSs, though that presumption could be overcome on the basis of user needs and a cost benefit analysis? If not, why not?

Response:

We are not able to prejudge the relevant modification of the recognition and measurement principles before the outcome of the extensive analyses of users' needs is known.

In our opinion both recognition criteria and measurement requirements could be different for SMEs compared to publicly listed entities even for the same assets or liabilities, as a result of differences in user needs, although the conceptual definitions of the elements of financial statements remain unchanged. Therefore, there should be no presumption that no modification should be made to recognition or measurement principles. We believe that both changes and retentions of IFRS recognition and measurement principles and disclosure requirements should be justified in relation to users' needs.

Issue 8: In what format should IASB Standards for SMEs be published?

Question 8a. Do you agree that IASB Standards for SMEs should be published in a separate printed volume? If you favour including them in separate sections of each IFRS (including Interpretations) or some other approach, please explain why.

Response:

We agree that the IASB standards for SMEs should be published in a separate printed volume and be comprehensive and readable as a stand-alone book.

Question 8b. Do you agree that IASB Standards for SMEs should be organised by IAS/IFRS number rather than in topical sequence? If you favour topical sequence or some other approach, please explain why.

Response:

In our opinion the IASB Standards for SMEs should be organised by topical sequence because this is more user friendly, particularly where preparers and users are unfamiliar with the structure and content of full IFRS. The numbering of IAS/IFRS reflects the historical sequence in which they were addressed rather than any internal logic. If the SME version follows the IAS/IFRS numbering it will not be sequential as some of the IFRSs are not relevant to SMEs. To enable comparison to full IFRS a concordance table is needed.

Updates of the SME standards may be considered for every amendment or endorsement of an IFRS/IAS standard. However, we believe that changes in IASB standards for SMEs should not be published more frequently than on an annual basis.

Question 8c. Do you agree that each IASB Standard for SMEs should include a statement of its objective, a summary and a glossary of key terms?

Response:

If the SME standards are organised by IAS/IFRS number then we agree that each IASB Standard for SMEs should include a statement of its objective and if necessary a summary. Glossary of key terms should be made for the whole set of standards, and not standard by standard. The printed volume should be readable as a stand alone document.

If the SME standards are organised by topical sequence we believe that there is only a need for statement of objectives and summary in the preface.

Question 9. Are there any other matters related to how the Board should approach its project to develop standards for SMEs that you would like to bring to the Board's attention?

Response:

- It is very important that users' needs are clearly defined by the Board before continuing the SME project. Based on the definition of users' needs the Framework applicable for SMEs or the

Preface should be exposed for public comment to obtain support for the direction of the IASB standards for SMEs.

- We recommend that the Board should not wait until all documents are drafted before public exposure of the Framework applicable for SMEs and standards. We recommend exposure drafts of the standards be made available to the public in form of batches. We expect a number of benefits from such an approach:
 - Comments received may be more focussed and therefore more useful to IASB;
 - Analysis of comments received may be a source of corrective actions for the Board to consider in preparing the batches; and
 - Projects such as the “Improvements” project have shown how difficult it is to manage a group of different standards simultaneously.

Nevertheless, the full set of standards should ultimately be exposed for public comment, since IASB’s own recent experience shows that there is often overlap between standards and constituents need to be asked to consider the package as a whole.

- We acknowledge the current work pressures on the Board. We therefore suggest the establishment of a permanent working committee actively involved in the SME project to support and relieve the Board. The members of this committee should be selected by the Board and be advisory only.