



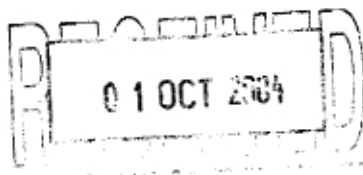
EUROPEAN COMMISSION

Internal Market DG
Director General

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Mr. Paul Pacter
International Accounting
Standards Board
30 Cannon Street
London EC4 M 6XH
United Kingdom



Subject: Preliminary Views on Accounting Standards for Small and Medium-sized Entities

Dear Mr. Pacter,

The Commission and the Member States, through the Contact Committee, are pleased to have the opportunity to provide their preliminary views on accounting standards for small and medium-sized entities. We support fully this initiative put forward by the IASB. The SME sector also needs high quality accounting standards. In Europe, the SMEs number several million entities and are major employers.

At present, there is some harmonisation of accounting standards for SMEs in Europe. However, further harmonisation in the area could be beneficial to the European Single Market, and for this reason the Board's SME project is welcomed though we consider that it might need a more bottom up approach focusing more on the needs for unlisted companies.

The views expressed in the paper attached to this letter as an Annex do not necessarily represent the views of all Member States but do reflect the consensus achieved.

Yours sincerely,

Alexander Schaub

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Encl. Annex

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ANNEX

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?*

Commission:

Normally the fundamental concepts and principles developed by the IASB, in its Framework and in its standards, might be suitable for all entities. Regarding SMEs the full IFRSs might go beyond the needs of the users of financial statements and thereby impose a heavy burden (too complex, too costly to apply) on those entities. Paragraph 10 of the Framework asserts that financial information that meets the needs of investors will also meet most of the needs of the other groups. In our view, the primary objective of the financial statements of most SMEs is the secondary objective set out in paragraph 14 of the Framework, namely that of stewardship. It is often the case with SMEs that the owners of the business are also managers, and hence their information needs are different. So whilst there is some commonality in the users of financial statements as between public companies and SMEs, the emphasis is more on lenders, trade creditors and management.

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

Commission:

We agree that the IASB should develop a separate set of financial reporting standards suitable for SMEs. Moreover, we want to stress that the drafting of a specific set of accounting standards for SMEs must be a process that will need large consultation with all parties concerned, in particular given the number of preparers which are potentially concerned. It is therefore vital to dedicate sufficient time to the due process of the project. Some of the accounting issues might be different for SMEs compared to listed companies and would therefore require a separate consultation.

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?*

Commission:

Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards¹ requires all publicly traded companies governed by the law of a Member State to prepare their consolidated accounts in conformity with the international accounting standards as adopted in the EU. Accordingly, the Commission does not favour specific IASB Standards for publicly traded SMEs.

¹ Official Journal L 243, 11/09/2002 P. 0001 - 0004

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?*

Commission:

We agree with the following objectives of IASB Standards for SMEs:

- a) Provide high quality, understandable and enforceable accounting standards suitable for SMEs globally;
- (b) Focus on meeting the needs of users of SME financial statements;
- (c) Be built on the same conceptual Framework as IFRSs;
- (d) Reduce the financial reporting burden on SMEs that want to use global standards.

Concerning the 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 this to be among the main objectives of IASB Standards for SMEs because the vast majority of SMEs will most probably never move to full IFRSs during their existence. However, the SME Framework should be close to the IASB Framework in order to accommodate and facilitate transition to full IFRS, but the Framework must be adapted to the specific objectives of financial reporting by SMEs and the users of the financial statements of SMEs. Some of the recognition and measurement principles under the IASB Framework should be modified to take better account of the users' needs e.g. leasing, fair values etc.

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?*

Commission:

We agree that the Board should describe the main principles characterising the entities for which the IASB Standard for SMEs is intended. These principles should provide the qualitative characteristics of an SME but not the quantitative size tests, which should be left to the individual jurisdictions to develop.

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?*

Commission:

We believe that the IASB Standard for SMEs should be firstly intended for the entities meeting the qualitative characteristics of the standard and secondly mainly for medium-sized entities and not for the smallest entities at all. It is particularly important to make this distinction between medium-sized and the smallest entities because in the latter case the entity might be very small i.e. a so called micro-enterprise for which the IASB Standard for SMEs would be too demanding. A preferable solution could be to have local GAAP for the smallest entities.

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?*

Commission:

The concept of "public accountability" is too complex and not very useful to apply in practice for the definition of an SME. This is because of the large diversity of situations in different parts of the world. The issue of "public accountability" should be left to the individual jurisdictions to decide. One alternative way to define SMEs could be to say that listed companies and micro companies are not within the scope of the standard for SMEs. We also think that a more appropriate term for the "IASB Standards for SMEs" should be found e.g. "IASB Standard for certain unlisted companies".

Question 3 d. *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?*

Commission:

We disagree with a requirement that one or more shareholder(s) could require the use of full IFRSs. This matter should not be dealt with by the IASB. Along the same line already taken with regard to 3(a), it should be up to the individual jurisdictions to determine the circumstances under which entities should not apply this regime. We do not consider it appropriate for the Board to get involved with this aspect of the scope of practical application of these proposals. This is not a standard setting issue.

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?*

Commission:

For the reasons set out under 3 (a) and 3(d) above, this issue should be left to individual jurisdictions to determine the most appropriate approach. It should not be dealt with by the IASB.

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?

Commission:

We agree that the IASB Standards for SMEs could have a mandatory fallback to a particular IFRS in the event that the IASB Standards for SMEs do not address a particular accounting recognition or measurement issue confronting the SME but only for that particular issue in question. Whilst there could be a mandatory fallback to a particular IFRS for a particular issue, there should not be any mechanism leading to a mandatory fallback to the full IFRS.

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?*

Commission:

Consistent with our comments on earlier questions of these proposals, we do not believe that the IASB Standards for SMEs should restrict options that are available under the full IFRSs. Consequently, we do not believe that this scenario should arise. We are not in favour of cherry picking, because we consider that a company should either use full IFRSs, or IASB Standards for SMEs, with the exception of the mandatory fallback addressed in Question 4.

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?

Commission:

See reply to question 5a.

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?

Commission:

We believe that the starting point should be to build on the IASB Framework for the financial reporting for SMEs whilst focusing more on the objectives set out in relation to question 1a. This means that the Board should reassess the objectives of SME financial reporting, the users of SMEs' financial statements and their needs. We do not believe that standards for SMEs should merely be reduced versions of the full standards.

We agree that the practical development of IASB Standards for SMEs might start by extracting the fundamental concepts from the Framework and the principles and related mandatory guidance from IFRSs. However, after the extraction, the necessary modifications and additions should be made to bring the standards in line with the Framework. Standards, which are not of relevance for SMEs, should not be taken over (for example IAS 33).

Interpretations should not be taken over and should only be used as guidance for SMEs. If they contain, by mistake, fundamental concepts, the standard for SME should be adjusted accordingly.

The extraction process should be transparent and be based on a few guiding principles.

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?

Commission:

We agree that the modifications for IASB Standards for SMEs to the concepts or principles in full IFRSs must be based first on the identified needs of users of SME financial statements and second on cost benefit analyses. We would invite the IASB to examine our responses to questions 2 and 6 on this matter.

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?*

Commission:

Before a reply can be given to this question an analysis of users' needs is required in order to clarify their needs. However, the general expectations are in deed that less disclosure and presentation requirements would be needed.

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?*

Commission:

No. The starting point in developing standards for SMEs should be that the recognition and measurement principles of full IFRSs should be modified to take better account of user needs. Cost benefit analysis should provide adequate justification that the benefits of improved information outweigh the cost. The recognition criteria and measurement requirements could be different for SMEs because the user needs are different from those of full IFRSs. See also our reply to question no 2.

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.*

Commission:

The IASB standards for SMEs should be published in a separate printed volume and it should be possible to use them without the Bound Volume. It is considered that this would allow preparers and users more convenient access to the relevant standards.

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.*

Commission:

The current distinction between IAS and IFRS is very confusing and should be avoided in the case of SMEs. In addition, the numbering of standards and interpretations is not continuous. Furthermore, we assume that the number of IASB Standards for SMEs will be less than for listed companies, thus never leading to the same numbering system as with full IFRSs.

Consequently, the IASB Standards for SMEs should rather be organised by topical sequence in order to facilitate their application. The IASB Standards for SMEs could even be published as a single standard.

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?

Commission:

Each IASB Standard for SMEs should include a statement of its objective, a summary and a glossary of key terms. The SME version of the standards should be readable as a stand alone document. The glossary could also be made for the whole set of standards.

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?

Commission:

There should not be a constant update of the SME standards when the full IFRSs are amended. The standards for SMEs should be amended only when there is a real perceived need to do so – and not just because a full IFRS is amended. We therefore see the body of standards for SMEs to be a relatively stable document with few and infrequent changes.