

EUROCHAMBRES Position Paper 2004



IAS FOR SMEs

**RESPONSE TO THE
INTERNATIONAL ACCOUNTING
STANDARDS BOARD'S (IASB)
DISCUSSION PAPER
"PRELIMINARY VIEWS ON
ACCOUNTING STANDARDS FOR
SMALL AND
MEDIUM-SIZED ENTITIES"**

SEPTEMBER 2004

General Remarks

In most countries in Europe, all or most enterprises are legally required to prepare financial statements. The vast majority of those companies are SMEs. Relatively few are currently required to follow International Financial Reporting Standards (IFRSs). Current discussions around the IFRSs clearly demonstrate the complexity of those standards. It is doubtful, whether such standards, even when simplified, could fulfil the needs of SMEs. For many companies, some aspects of the International Financial Reporting Standards (IFRSs) are too complex. The IFRSs/IASs contain extensive disclosure requirements that place especially high demands on companies but do not offer benefits that justify the additional work involved.

Having said this, for EUROCHAMBRES it is a precondition that the development of separate standards must not result in any legal obligations on SMEs to apply international accounting standards. Companies must retain the option of preparing financial statements on the basis of national accounting standards only. The IASB's discussion paper points out in several contexts the role of national regulatory authorities in requiring or permitting to use standards for SMEs. We do not believe there should be any obligation to follow SME-IFRS-standards because the costs of following IFRS-standards exceed the benefits. If special standards for SMEs are developed, there should not be any mandatory obligation for SMEs to follow the standards. The special standards should only be a choice available to SMEs.

The discussion among our members shows that there cannot be a standard regulation for all entities regardless of their structure and size. The needs of SMEs must therefore be precisely analysed to identify which accounting standards best meet these needs. In this process harmonisation should not be seen as a greater priority than the needs of the enterprises.

We welcome the fact that the IASB has opened the development of international accounting standards for small and medium-sized enterprises to debate in the form of an open consultation.

EUROCHAMBRES' detailed comments and proposals concerning this proposal are elaborated on the following pages. However, in summary, the Chambers strongly encourage the International Accounting Standards Board to:

- Use a voluntary approach,
- Avoid any double burden for SMEs,
- Continue an open discussion,
- Ensure that IFRSs for SMEs are not constantly revised and,
- Reduce the volume of reporting and thereby the costs.



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

Question 1a.

Do you agree that full IFRS should be considered suitable for all entities? If not, why?

No. The full application of IFRSs/IASs is unsuitable for SMEs - even on the basis of voluntary application. IFRS are becoming more and more complicated from year to year and it is difficult to follow the ongoing amendments and changes. The extensive disclosure requirements (e.g. regarding pension requirements or deferred taxes) can be fulfilled only by accounting professionals of big companies. This would place a huge burden on SMEs that cannot be justified neither by the information needs of the users nor with regard to the cost-benefit ratio.

SMEs do not require such detailed financial analysis for making economic decisions as is the case for large size entities. The typical characteristics of SMEs (i.e. a smaller number of owners, who are usually also actively involved in the management or are in very close contact to the management) mean that they have different information needs and different disclosure requirements from publicly listed companies. In view of this, we are in favour of the development of separate standards for SMEs. It must be ensured that these are attuned to the needs of the users and also lead to a reduction in the cost burden.

Question 1b.

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

The development of separate standards can be an interesting **option** for certain companies and can facilitate the transition to the international financial reporting standards, in so far as these standards take account of the typical needs of SMEs. The existing scope of the current IFRSs by far exceeds the needs and requirements of SMEs. It is important to ensure that IFRSs for SMEs are not constantly revised. Constant changes to standards would place too much of a strain on SMEs. We reject a legal obligation by European or national legislators to introduce a mandatory application of the IFRSs for SMEs to be developed. Companies should be free to decide whether they want to apply national regulations or IFRSs for SMEs or the normal IFRSs. International comparability of financial statements is not relevant for some companies.

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

We basically agree with the objectives as set forth in the discussion paper, although it is uncertain whether these objectives can be reconciled with the principles of the IAS/IFRS framework. However, the objectives must be defined more precisely in order to be able to analyse this. If IFRSs for SMEs are developed, they must be reliable and must not be changed constantly. The information needs of management and other users should still be taken into account so that the application of international accounting standards can also make a convergence of external and internal accounting possible. The objective of reducing the volume of reporting (and thereby the costs) should be considered a priority in the development of standards for SMEs.



Question 3: For which entities should IASB Standards for SMEs be intended?

3a.) Do you agree that the Board should describe the (qualitative) characteristics of the entities to which it intends to apply the standards but that those characteristics should not prescribe quantitative "size tests"? If not, why?

We believe that entities should be able to decide whether they prepare statements according to IFRSs, IFRSs for SMEs or national standards (exception: entities which are required to report on the basis of IFRSs according to IAS law 1606/2002). It is therefore questionable whether the IASB should define the application area for IFRSs for SMEs at all. We do not think it is necessary to define additional exclusion criteria. The IAS law of the European Commission requires the use of IFRS/IASs at European level. **All entities not required to use IFRS/IASs according to the IAS regulation should therefore be able to use the standards for SMEs.**

3b.) Do you agree that the Board should develop standards which 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?

We do not think it makes sense to focus only on relatively large/small entities. However, as we already state in our response to question 3a, all companies not required to use IFRS/IAS according to the IAS regulation of the EU Commission should be able to use IFRS for SMEs. Regarding the criterion of public accountability we refer to our answer 3c.)

3c.) Do the two principles described above, combined with the indicators of "public accountability" also described above, provide a workable definition and appropriate guidance for applying the concept of "public accountability"? If not, how would you change them?

EUROCHAMBRES does not agree with the IASB's definition of publicly accountable entities. We do not think it is appropriate to define an entity as publicly accountable if it is in the focus of investors. This is because basically every entity is potentially accountable to investors as part of its obligation to offer favourable investments or returns. However, this should not be defined as public accountability. Also, rendering of public services should not exclude companies from applying IFRSs for SMEs. Overall, we think the definition of publicly accountable entities is too broad. The European Chambers generally do not understand why the IASB wants to incorporate public accountability into international accounting issues in so far as public accountability goes beyond capital markets.

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?

There must not be a legal obligation to use IFRSs for SMEs. For this reason EUROCHAMBRES cannot follow the IASB's line of argument. If an entity is not obliged to use IFRSs, but not all shareholders approve the use of IFRSs for SMEs this cannot lead to an obligation to apply IFRSs. In



our opinion, the requirement for all shareholders in a publicly owned entity to approve the use of IFRSs is not appropriate. A minority shareholder should not have the possibility of ruling out the use of standards. Operational company decisions are usually not made unanimously. We see no reason why the use of the standards requires the vote of all shareholders when all other operational decisions usually do not require this.

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?

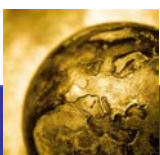
EUROCHAMBRES does not agree with the opinion of the IASB. The reporting requirements of subsidiaries usually differ in the degree of detail to the annual accounting requirements.

Firstly, the information required by the parent company for drawing up the annual accounts is often requested from the subsidiaries in the form of so-called reporting packages. This is not comparable to drawing up annual statements according to the current IFRS/IAS.

Secondly, subsidiaries are often prescribed group accounting and measurement methods for the purposes of the consolidated accounts so that the current IFRS/IAS are applied in principle, but in a form tailored to the needs of the consolidated financial statements (e.g. restricted measurement methods etc.). The entity must be able to decide freely whether to draw up its separate financial statements according to the current IFRS/IAS, the IFRSs for SMEs or according to national accounting standards.

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?

Fallback to the appropriate IFRS/IAS should be possible if standards do not address a particular issue. Allowing entities to develop their own accounting recognition or measurement rules would put the consistency and significance of financial statements at risk. However, fallback should not place an unjustifiable burden on SMEs. Therefore, some companies would prefer a fallback option to the respective national or alternative regulations.



Question 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?

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?

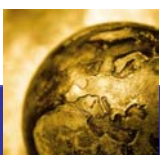
It is questionable whether these options would not impede the comparability of financial statements, cf. answer to question 4. This point cannot be answered until a rough concept of SME standards has been settled on.

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)?

This question cannot be answered until a draft of SME standards has been drawn up. We basically support a "standard-by-standard" approach, i.e. variant a) above.

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?

EUROCHAMBRES agrees with the IASB's opinion. Using the same starting point is the only way to guarantee that, for example, the financial statements of entities are comparable and that a smooth transition to IFRS/IAS is possible without major difficulties. However, we doubt whether this will relieve the burden on SMEs significantly. Because of this, the modifications should be discussed in the context of the introduction of measurement options.



Question 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?

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?

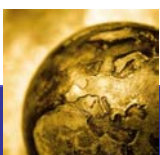
For EUROCHAMBRES, it is of prime importance that the modifications of the IAS/IFRS are derived from the needs of SMEs, and particularly the cost-benefit ratio.

7b). 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? Do you think the board should allow modifications on the basis of user needs and a cost-benefit analysis? If not, why?

A reduction of the disclosure requirements would, in our opinion, provide considerable alleviation. However, an exact evaluation of the question is not possible before a draft of the standards for SMEs has been presented. Simplified measurement procedures should also be discussed.

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? Do you think the board should allow modifications on the basis of user needs and a cost-benefit analysis? If not, why?

We refer to our comments in 7b). We do not support revoking voting rights for recognition or measurement principles. Entities should keep all their voting rights. Instead, additional alleviation measures should be created that meet users' needs more effectively. However, this issue cannot be addressed until a draft version of standards for SMEs is available.



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

8a) What format should the standards for SMEs have?

The IASB Standards for SMEs should be published in a separate, independent form. We believe that this would also be more practical than integrating them in the IFRSs.

8b) How should the standards for SMEs be numbered?

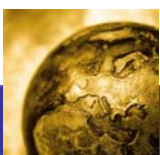
The IFRS for SMEs should be oriented to the IFRS/IAS numbering. Especially if the fallback option put to discussion above is granted.

8c) What structure should the standards for SMEs have?

We agree with the IASB, although the section "Glossary of key terms" should not lead to the definitions essential to the standard being taken out.

Question 9: Any other questions and comments?

A transparent and open development of IFRSs for SMEs and also of IFRSs is of great importance to their acceptance among users. The comments, especially those of companies, to the IASB should therefore receive due consideration. In addition, the question of whether and to what extent the IFRIC interpretations concerning the IFRSs for SMEs are included should be discussed.



EUROCHAMBRES on the International Accounting Standards Board's (IASB) discussion paper regarding the development of international accounting standards for small and medium-sized entities (SMEs)

This position paper has been produced by EUROCHAMBRES, the Brussels based Association of European Chambers of Commerce and Industry.

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