financial executives international

Committee on Private Companies

September 23, 2004

Mr. Paul Pacter
Director of Standards for SMEs
International Accounting standards Board
30 Cannon Street
London EC4M 6XH, United Kingdom

Dear Mr. Pacter:

The Committee on Private Companies ("CPC") of Financial Executives International ("FEI") appreciates the opportunity to respond to the International Accounting Standards Board (the Board) *"Preliminary Views on Accounting for Small and Medium Sized Entities"* ("Discussion Paper"). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives, nearly half of whom are from non-public, for profit companies. CPC is a technical committee of FEI, which reviews and responds to existing or proposed legislation or regulations that affect non-public companies. More than 250 private companies are represented in CPC. This document represents the views of CPC and not necessarily the views of all FEI members.

We appreciate the recognition that there are accounting issues unique to certain types of entities which the Board has defined as Small and Medium Sized Entities (SMEs), when applying International Financial Reporting Standards (IFRS), and we appreciate the time and effort the Board has devoted to exploring whether a separate set of standards is necessary for such entities. That said, we have several concerns with the overall project and the haste with which the Board seems to be proceeding on this issue.

With regard to definitions, we would identify two areas of concern:

First, type of entity to which unique standards may apply. So there is no ambiguity in their applicability, we feel it important for the Board to clearly identify whether these standards apply to non-public entities or to small and medium-sized entities (in which case size becomes the defining criterion, leading to the problems already stated in Preliminary View 3.1). Non-public entities and SME's are not characteristically interchangeable definitions. Clarity of this definition would also aid in interpreting the pertinence of the standards.

Our comments are from the perspective of companies wherein ownership and capital structure are in a private format, meaning that in the United States, the company is not registered with the Securities and Exchange Commission. Our perspective does not distinguish between size of entity, because many private companies have substantial revenues. The Discussion Paper focuses on SMEs, without regard to ownership or capital structure characteristics.

Audited financial statements or financial statements prepared by accountants without audit are, we believe, only prepared for those financial institutions and persons that lend to a private entity. It would also be our perception that lenders and shareholders to private entities have far greater access to the principal owners and management than in a publicly traded company.

Further, as private companies become larger and have greater need to access more sophisticated forms of debt, potential lenders and investors will determine the applicability of certain types of standard <u>reporting</u> and <u>accounting</u>, thereby eliminating the need to have a "size test." All of these perspectives permit the definition of the targeted audience for differential standards to be private companies that (at least in the United States) are not registered with the Securities and Exchange Commission.

Second, the Discussion Paper is not clear as to what is meant by "separate standards". Is the Board referring to separate reporting standards or to separate accounting standards? This inconsistency easily arises, in our opinion, because there has not been a clarity of why the issue of differential accounting is being addressed. Has there been a study to determine the standards – reporting or accounting – that precipitated the need for this discussion? If reporting or disclosures are the issue, we would entertain certain changes, but separate accounting standards would not be appropriate, as we believe that regardless to size and type of entity that accounting treatment should be the same.

Regarding differential accounting treatment for SMEs as opposed to their larger, publicly accountable counterparts, we have concerns on several levels.

1. We are concerned that the Discussion Paper does not seem to be globally inclusive, that is, does not take Generally Accepted Accounting Practices (GAAP) into account, but is rather concerned only with IFRS. Anticipating global convergence in accounting standards, we are concerned that if the Board adopts separate IFRS standards for SMEs, global convergence of standards may become more difficult.

2. We are concerned about the speed with which the Board seems to be proceeding with this initiative. We agree with the Board that there are concerns with regard to a privately held company (as opposed to a generic "SME") that may be required to incur considerable cost to comply with full IFRS (or GAAP) to produce and report information that may be of little benefit to the company's investors, creditors or clients. However, we think these issues should be carefully studied, contemplated and clearly defined before reaching the conclusion that a separate set of accounting or reporting standards is required.

   Indeed, in the United States, there are groups ranging from the state CPA societies, to the American Institute of Certified Public Accountants, which are in the research and analysis stage of determining whether the present audited financial statements of private companies or financial statements prepared by accountants without audit are of benefit either to owners or, more broadly stated, to capital providers to the entity.

Should the Board decide to proceed with its plan to produce differential accounting treatment for SMEs, and lacking the benefit of substantial research, and studies, we have additional concerns as follows.

1. We are concerned about the process for <u>conversion</u> from one accounting standard (SME) to another accounting standard (IFRS) due to growth, acquisitions, or public registration of debt or equity. How would past financials be presented when an entity has look-back years and the need to reconcile two different standards? What would the Auditor's Opinion state?

2. We are concerned that separate accounting would make comparability of financial statements between different entities difficult. We believe that accounting standards should be fundamentally sound and comparable, whether one is comparing IFRS or GAAP statements and separate accounting standards for SMEs would make comparability more problematic.

Regarding differential reporting treatment for SMEs as opposed to their larger, publicly accountable counterparts, we intuitively are supportive of this effort, but need to understand the process a company would follow to convert from one reporting standard to another.

In conclusion, it is our recommendation that the Board further study this issue before issuing separate accounting or reporting standards for SMEs, as defined in the Discussion Paper. The study should focus on clarity as to the need for differential standards. If a need is found, then further identification of which standards (reporting, accounting) and the specific standards related to the issues of need for differential accounting should be identified.

Thank you again for providing us the opportunity to comment on these important issues. Should you wish to discuss this matter further, please E-mail me at jatkinson@arielcapital.com.

Sincerely,

James W. Atkinson

James W. Atkinson, Chairman
Financial Executives International
Committee on Private Companies

cc: US Financial Accounting Standards Board (FASB) and the FASB Small Business Advisory Committee.