



Brussels, 28th September 2004

**Comments by the EACB regarding
the IASB's discussion paper "Preliminary Views on
Accounting Standards for Small and Medium-sized
Entities"**

GENERAL REMARKS:

The European Association of Cooperative Banks (EACB)¹, who is one of the founding members of EFRAG, is generally in favour of the IASB's project aiming at developing a set of IFRS for SMEs. As Member States of the European Union have the option under Regulation 1606/2002/EC to extend the scope of application of IAS/IFRS to non-listed companies, it is indeed of utmost importance that SMEs could fall back on a set of IFRS particularly adapted to their specific context.

While it is of interest to remain as consistent as possible with the set of full IFRS, we underline that IFRS for SMEs should foremost address the financial reporting and information needs of the respective users of SME financial statements, among which banks take a prominent place.

As the great majority of SMEs are rather small, not listed on a stock exchange and nearly rely exclusively on lending finance, we expect the principles and the framework of IFRS for SMEs to reflect these differences and to be to quite some extent divergent from those of the full IFRS. In particular, we underline that the specificities of cooperatives, most of which we expect will qualify as SMEs, should be taken into account when working on the SME-equivalent of such sensitive standards as IAS 32 and IFRS 3. Also, great care should be taken to keep the volume and complexity of such standards as low as possible to ensure proper application by smaller entities.

Therefore, the subject should be thoroughly investigated, so as to determine the real needs of users and the specificities of preparers as well as to undertake a cost benefit analysis. This should be the precondition and the starting point of any development of IFRSs for SMEs. In this regard, we do not deem the IASB's tentative schedule for the project to be adequate and suggest that a much longer horizon be adopted, so as to allow a meaningful analysis and proper consultation of all parties involved with sufficient response periods.

¹ The European Association of Co-operative Banks represents over 4.500 co-operative credit institutions active in all the EU Member states and serving over 100 Million customers. Its member organisations are decentralised national networks of small-sized Co-operative banks' networks, which have a strong presence on a local or regional level. They account for a large part of the SME and private household credit market (17%) and thus play a crucial role within the Internal Market.



With regards to the issue of which companies should be considered as SMEs and should fall under the scope of application of the IFRSs for SMEs, we underline that it is up to the respective legislator to decide on the appropriate solution for the local economy and its SMEs.

DETAILED REMARKS:

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

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

The analysis of users' needs and of preparers' specificities as well as a Cost-benefit analysis are, in our view, the first step of a project of drafting an international set of accounting standards for SMEs.

If users' needs and preparers' specificities in the context of SMEs appear to require less sophisticated or less comprehensive requirements than is the case with IFRSs designed for an investors' world, then IASB standards for SMEs should be quite different from full IFRSs.

The EACB expects full IFRS to be unsuitable for the SME context, not only from the user's but also from the preparer's perspective. Thus, e.g., developments over the last two years have shown that several IAS/IFRS pose particular problems for cooperative entities, many of which would qualify as SMEs, as they do not properly address their economic realities.

Also, the complexity and sheer volume of full IFRSs are likely to make their application and thus accurate reporting an enormous challenge for smaller preparing SMEs. We believe that greater sophistication and more comprehensive financial reporting are not necessarily for the better, and should be avoided, if the information provided is not essential for the main users of the financial statements. In turn, ensuring that smaller entities can cope with the level of required reporting would also ensure a higher degree of reliability, which, in fine, is also in the interest of the user.

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

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 developed in Europe. As cross-boarder business is developing quite rapidly and is no longer the exclusive arena of large international groups, we see the IASB project as a chance to harmonise accounting standards and to achieve comparability in financial statements over time and between entities within Europe and worldwide. Adoption of a common set of accounting standards is an important objective, also for SME financial reporting.



We believe, that IASB standards for SMEs should be designed on the basis of users' needs and preparers' specificities, among which those of cooperative entities. We therefore suggest that first a thorough investigation of this data should be conducted in the context of SMEs. From that analysis, differences from the users' needs as reflected in IFRS would be identified. Only then, we believe, it will be possible to ascertain whether the present full IFRS could be used as a starting point and, if yes, to what extent they would need to be modified for SMEs.

On the basis of the knowledge we have of both IFRS and the context of SMEs, we believe that differences in users' needs will substantiate the need for a set of financial reporting standards for SMEs different from IFRS. We also believe that users in an SME environment might require less complex and less sophisticated financial reporting.

The main target user of the present IFRSs is the investment world. Investors need financial information to analyse and conclude whether to keep, buy or sell their equity investments. For this purpose they need detailed financial information to prepare an indicative valuation of the entity including expectations of future profit. However the needs of users of SME financial statements might be different as these financial statements are mainly used to:

- Assess stewardship or accountability of management;
- Assess ability of the enterprise to pay and provide other benefits to its employees and to meet its obligations towards lenders, creditors and customers 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.

IASB 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?

In principle, the EACB supports the view that no publicly listed company should be able to use IFRS for SMEs instead of full IFRS. However, we also agree with the Board's view, expressed in paragraph 13 of the Preliminary views that the ultimate decision on who uses the standards rests with the national regulatory authorities and standard setters.

In the EU's case, IFRS will be binding for listed companies that present consolidated accounts from 1st January 2005 onwards as result of Regulation 1606/2002/EC.

On the other hand, the matter may be a non-issue, as we would expect that a functioning market would sanction any listed company refusing to report according to full IFRS by a discounted stock-price, thus discouraging those entities from doing so.



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

IASB 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?

We have strong reservations in relation to the objectives regarding transition and the framework as set out in preliminary view 2.

The importance of the transition to full IFRSs should not be overstated, as most SMEs potentially applying IFRSs in the future might not necessarily do so because they intend to go public, but rather because national requirements might force them to do so or because it suits their needs in cross-border business, particularly in the case of EU undertakings. Therefore, transition should not figure as an objective.

We believe that the third objective prejudices on the outcome resulting from analysis of the user and preparer needs. In our opinion a Framework for SMEs should start with a clear identification of users and users' needs and a clear definition of the scope of entities for which IASB Standards for SMEs are intended. We believe that the users should be given the following priority: 1. Lenders, 2. suppliers, 3. employees, 4. customers and 5. existing shareholders (in the private equity world, potential investors have access to detailed financial information beyond financial statements, if they identify the need for such supplementary information).

Concerning the concept of public accountability, please refer to our response to question 3 (c) below.

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

IASB 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?

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.

Much rather, the national definitions, which are usually expressed in number of employees, turnover and balance sheet total, depend on the economic structure and on traditions of the respective countries. As a result, an SME in Germany could be considered a large company in e.g. Costa Rica. Even within the European Union, stark differences exist between national definitions. On the other hand, size tests are inappropriate as they have a discriminatory effect depending on the business activity in question. Thus, a small trading company with a limited number of staff could easily exceed turnover figures stated in a formal SME definition.



In our perception, the most practical SME-definition would be that of the unlisted company preparing financial statements, it should then be left to the national jurisdictions to narrow down the scope in accordance with their national context.

IASB 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?

We agree that the Board should not only focus on the relatively larger entities or the relatively smaller entities in setting the IASB Standards for SMEs. As stated in the answer above, the main focus should be on the majority of unlisted entities that prepare financial statements and then it should be left to the national jurisdiction to decide whether some entities should be scoped out.

We underline again that a set of IFRSs for SMEs should be suitable to cooperatives by taking their specificities into account, as we expect most of such entities to qualify as SMEs. Particular attention should be paid to the SME-equivalents of sensitive Standards, e.g. IAS 32 and IFRS 3.

Concerning the concept of public accountability, please refer to our response to question 3 (c) below.

IASB 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?

In our opinion public accountability is a very broad and high-level notion and we believe that IASB is not in the position to describe and consider this.

We believe that it should be up to the respective national jurisdictions to decide which unlisted companies should fall into the scope of IFRS for SMEs. We expect the local authorities to dispose of the most accurate information and judgement regarding the economic context and user needs in order to make an adequate decision.

IASB 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?

We agree that an entity should be required to use IFRSs if shareholders object to the entity’s preparing its financial statements on the basis of IASB standards for SMEs to protect the minority shareholders that are depending on the information in the financial statements as they are their only source for information. However, we believe that one shareholder as a threshold is too low. It should be left to the national jurisdictions to define a threshold.



IASB 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?

No, 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 with IFRSs in its separate financial statements. This is to be decided by the group or national company law. 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. IFRSs for SMEs should be preferable whenever they are more pertinent to the users of the financial statements, with a view of establishing the credit-worthiness and solvability of the subsidiary, joint venture or associate. 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 adequate level of information for consolidated accounts to be prepared in accordance with IFRS.

As stated in our answer to question 1 a), we do not believe that the more information, sophistication and detail, the better financial reporting.

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?

IASB 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?

We agree that if IASB Standards for SMEs do not address a particular accounting recognition or measurement issue, it should be solved by mandatory fallback to IFRS, if and only if however, this fallback is consistent with the framework applicable to SMEs. In our view, the scope of the fallback should be as limited as possible and IASB Standards for SMEs would apply for the remainder of its financial statements. The relevant IFRS should in our opinion be applied in a way that all of the principles (recognition, measurement and disclosure) related to transactions not addressed in the SME Standards are applied. This approach ensures consistency between recognition, measurement and disclosure.

Each SME Standard should explicitly mention whether mandatory fallback is required with a reference to the specific IFRS. If there is no mandatory fallback paragraph in the SME Standard, the entity should fall back to the framework applicable to SMEs to solve the recognition or measurement issue.

If the underlying principles and frameworks of the two sets of standards end up being quite divergent, it has to be examined whether such an approach is feasible, or whether another solution should be found by referring to national GAAP.



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?

IASB 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?

In our opinion no general optional reversion on recognition and measurement issues to IFRSs should be allowed. To revert to an IFRS should be permitted, if the change by applying the IFRS standard results in financial statements that provide more reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows (IAS 8). Such reversions should always be compatible with the SME framework.

In accordance with the principle related to a change in accounting policy, the justification and consequences of using IFRS instead of SME standards should be disclosed in the financial statements not only on first time adoption of the IFRS principle but also thereafter.

We expect the optional reversion to be used only in rare circumstances. The intended use of the reversion should be as restricted as possible and consistently applied.

Additional disclosures should always be permitted.

IASB 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?

If a SME entity reverts to an IFRS, because it results in financial statements providing more reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows, it should in our opinion be permitted to revert to the IFRS standard by using a principle by principle approach. An SME should be 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). Principle by principle means in our opinion that all



requirements in the specific IFRS standard on recognition, measurement and disclosure related to the transactions for which the entity reverts to the IFRS are complied with.

If the requirement to revert to IFRS is on a standard by standard approach, it will not be logical or relevant that the entity might have to change accounting principles for more than the intended transactions.

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?

IASB 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?

While it appears to be practical to start from the existing set of full IFRS, such an approach should not prejudice that those concepts and principles should be minimally changed. As already expressed in our previous answers above, we expect the framework and principles for IFRS for SMEs to be quite different from those of full IFRS. In any case, if SME standards are to be “preparer”-friendly, their text volume should only represent a fraction of the documentation of the present set of full IFRS.,

If the IASB were to proceed by extraction of the fundamental concepts from the framework and the principles and related mandatory guidance from IFRSs, we suggest the following steps should be followed:

- analysis of specific users’ needs and how they differ from users’ needs best served by IFRS,
- analysis of specificities relating to certain preparer groups, among which cooperatives,
- definition of the Framework for IASB Standards for SMEs,
- only then, modifications and additions to render the standards more suitable for SMEs.

Standards, or part 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 (either in the framework or in a preface) to transpose IFRS into IASB standards for SMEs. Analyses on the extracted standards should be conducted: both changes from and retained requirements should be justified in the Basis for Conclusions standard by standard, based on users’ needs.

Interpretations should in our opinion not be modified but their relevance for SMEs should be determined as it is not possible to extract fundamental concepts of Interpretations.

Extracting the fundamental concepts 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 interpretations that, either consistency with IFRS and comparability would



never be achieved, or fallbacks to IFRS guidance would be needed all along. The necessary illustrations and guidance will have to be sorted out, adjusted or created 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?

IASB 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?

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 cost benefit analyses. In addition, however, the specificities of particular preparer groups, such as cooperatives, also need to be taken into consideration.

In our opinion it is not useful to start modifying IFRS before the users' needs are clearly defined and a SME framework (or preface) is determined, and have been exposed for public comment. We are concerned that as long as the SME framework (or preface) has not been submitted to the public comment, this process might imply difficulties in achieving the SMEs project. Nevertheless, it would help respondents if the solicitation of views on user needs were accompanied by examples of the sort of changes to IFRS that might follow from various possible definitions of user needs.

IASB 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?

As Preliminary View 2 states the reduction of the "financial reporting burden on SMEs that want to use global standards" as one of the objectives of IFRSs for SMEs, we would definitely expect disclosure and presentation requirements to be less complex than with full IFRS. If this were not the case, the stated objective would be meaningless.



IASB 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?

There should not be any assumptions, as long as the proper investigation of users' needs, and of preparers' specificities have not been conducted and a cost-benefit analysis has not been undertaken.

In our opinion both recognition criteria and measurement requirements could be different for SMEs compared to 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 assumption, rebuttable or other, that no modification should be made to recognition or measurement principles. As indicated in our answer to question 6, 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?

IASB 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.

IFRSs for SMEs should be published in a stand-alone version. This would underline the fact that they are a set of standards separate from the full IFRSs.

Having them included in separate sections of each IFRS could potentially lead to confusion, especially if the provisions between the full IFRS and the IFRS for SMEs are contradictory.

IASB 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.

We have no marked preference.

IASB 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?

We agree that each IASB Standard for SMEs should include a statement of its objective, a summary and a glossary of key terms, which would make the standards more "preparer"-friendly. The printed volume should be readable as a stand alone document.



IASB 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?

- It is of high importance that users' needs are clearly defined and preparers' specificities properly taken into consideration by the Board before continuing the SME project. Based on this information, the SME Framework or Preface should be exposed for public comment to obtain support of the direction for the IASB standards for SMEs.
- We ask the Board to reconsider the comment deadline, so that the respondents have a reasonable period of time to provide their comments.
- We recommend that the Board does not wait until all documents are drafted before public exposure of the framework and standards. We recommend exposure drafts of the standards to be made available to the public on a standard by standard or on a batch basis. We expect various benefits from such an approach:
 - Comments received would be all the more relevant and justified that proposed standards would be issued progressively over time
 - Analysis of comments received might be a source of corrective actions for the Board to consider in preparing the following standards
 - A project such as the "Improvements" project has shown how difficult it is to manage a group of different standards all at the same time

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.