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Mrs Charlotte Norre
Project Manager EFRAG
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20 September, 2004

Re : Draft for comments: Response on discussion paper re Preliminary Views on Accounting Standards for Small and Medium-sized Entities.

Dear Mrs Norre,

We are pleased to provide our comments on the draft response on discussion paper re Preliminary Views on Accounting Standards for Small and Medium-sized Entities.

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?

We agree that IFRSs in principle are suitable for all entities including SMEs as the objectives of general purpose financial statements are fundamentally the same for all entities. But suitability of IFRSs for SMEs depends in our opinion on users' needs. Before those users' needs are analysed in the context of SMEs, we cannot evaluate whether IFRSs, as they stand, are suitable for SMEs. Such an analysis is, in our view, the first step of a project of drafting an international set of accounting standards for SMEs, derived from the present IFRSs

If users' needs in the context of SMEs appear to require less sophisticated or less comprehensive requirements than users' needs as reflected in the IFRSs designed for an investors' world, we believe that IASB standards for SMEs should be different from IFRSs. A focus on the specific users' needs will add more value to the users of SME financial statements. 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.

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.

In addition, as IASB standards for SMEs are meant to be as close to IFRS as is reasonable, it would make transition to IFRS easier for those entities that have to adopt IFRS because they become listed or have public debt obligations or have other reasons to apply IFRS.

We believe, as suggested by the Board, that 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. 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 to what extent the present IFRS needs to be modified for SMEs.

However, on the basis of the knowledge we have of both IFRS and the context of SMEs, and without presuming on the outcome of the necessary analysis, we believe that differences in users' needs might 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. Our knowledge of the SME environment suggests the following.

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.

Users of SME financial statements focus more on the ability of the entity to generate future cash and cash equivalents in the context specific to the entity's strategy and nature of operations than on the

present value of the entity and future profit, determined with the market reference being given the highest priority. User needs in relation to buying and selling of equity investment are probably of less relevance to SMEs given their private and closer ownership structure. The shareholders need to determine easily distributable profits and dividends, this being one of the important decisions they have to make.

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?

We 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. If a jurisdiction elects IFRS for SMEs as the set of standards for publicly listed entities, they should in our opinion have to re-label the standards as it should not be allowed to state compliance with IASB standards for SMEs.

As mentioned, the priority in developing a set of accounting standards for SMEs is to focus on the users' needs from a SME perspective and not to give e.g. publicly listed entities the opportunity to apply a new set of standards. Applying the Standards for SMEs without meeting the definition of a SME could generate financial statements that would not comply with the Framework. It is therefore inappropriate. Users might be deprived of relevant information to them and be misled into wrong economic decisions.

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?

The objectives as set out by IASB are fully supported. In particular we believe there is no need to adjust the present IFRS framework. If a guidance specific to SMEs is deemed required, it should not, in our opinion, amount to more than an interpretation of IASB standards for SMEs. An interpretation could emphasise that essentially the same principles are being applied in the IASB standards for SMEs as in IFRS though permitting some exemptions in the context of a lower degree of complexity in the entities involved.

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?

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.

We furthermore agree that it should be left to the national jurisdictions to determine whether all entities that meet those characteristics, or only some, should be required or permitted to use IASB Standards 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?

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. The main focus should be on the users' needs for the identified SME entities, and then it should be left to the national jurisdiction to decide whether some entities should be scoped out.

However, we recommend the Board prepares some guidance to point out for which entities the IASB Standards for SMEs may not be suitable. Indeed, very large or complex entities might enter transactions that require the level of sophisticated financial reporting that IFRS allow. On the other end of the scale, the benefits of worldwide accepted accounting standards are of no use to very small 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?

We believe the broad principles expressed by the Board are acceptable and that they should be retained.

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 (or a minority of shareholders) as a threshold is too low. It should be left to the national jurisdictions to define a threshold.

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?

We agree that if a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with IFRSs to meet the requirements of its parent, venturer or

investor, the entity should comply with IFRSs, and not IASB Standards for SMEs, in its separate financial statements. The cost saving issue would not be applicable in such a case, and, in addition, we do not believe it would be appropriate to privilege a class of shareholders versus a different class.

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?

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.

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?

In our opinion no optional 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 if the 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. We believe also that the adoption of either IFRS or IASB standards for SMEs should be consistently applied.

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 unique 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 principlebyprinciple 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 standardbystandard and principlebyprinciple approach)?

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

This question is not applicable in respect of our answer in 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?

We agree that IFRS should be the starting point in the development of IASB Standards for SMEs because:

- IASB standards for SMEs should be as close to IFRS as feasible,
- From a pragmatic standpoint, it is easier and less costly to identify differences than to start from a blank sheet.

Proceeding by extraction of the fundamental concepts from the framework and the principles and related mandatory guidance from IFRSs seems therefore appropriate. We however do not believe this should be the “starting point”. In our view the following steps should be followed:

- analysis of specific users’ needs and how they differ from users’ needs best served by IFRS,
- definition of the Framework for IASB Standards for SMEs as outlined in our answer to question 1b) Alternative 1, or if it is decided that there is no framework specific to SMEs, definition of a preface that present the rationale used for setting a separate set of accounting standards for SMEs and differentiating them from IFRS
- 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?

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.

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 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. We believe that in taking into account user need, a major consideration should be given to the cost-benefit ratio of the standards.

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 extensive analyses 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?

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 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. 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?

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.

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.

We agree that IASB Standards for SMEs should be organised by IAS/IFRS number rather than in topical sequence because of the reversion or transition to IFRS. By using the same IAS/IFRS number there is a logical reference to IFRS. In addition IASB could provide a concordance table cross referencing issues to the relevant standards.

Updates of the SME standards shall be considered for every amendment or endorsement of an IFRS/IAS standard. We however believe that changes in IASB standards for SMEs should be less frequent.

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. The printed volume should be readable as a stand alone document.

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?

We do not have additional significant comments.

Yours sincerely,

Prof. Angelo Provasoli
(OIC – Chairman)