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cc Sir David Tweedie, Chairman IASB
cc Johan van Helleman, Chairman EFRAG TEG

Dear Ms Bullock,

Re: <u>UNCTAD/ISAR Consultation Paper 'Accounting and Financial Reporting Guidelines for SME (SMEGA)'</u>

FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) welcomes UNCTAD/ISAR initiative for 'Accounting and Financial Reporting Guidelines for SME (SMEGA)' given the need for international accounting guidance for smaller entities in particular in developing countries and economies in transition.

We recognise a real need for a unique set of international accounting standards for SMEs. In the EU, according to 1606/2002 EC Regulation (IAS Regulation), from year 2005 IAS will be compulsory for the consolidated accounts of listed companies, and Member States will have the option to require or allow IAS for other classes of companies and/or for the individual accounts. IAS will therefore become much more important for Europe and will also influence the accounting for SMEs either directly for those that are listed or indirectly by their influence on the national accounting standards. In a number of countries, the convergence of national accounting standards towards IAS is in progress. In Europe there is therefore an urgent need for IAS specifically tailored for SMEs.

FEE therefore welcomes the IASB project on 'Accounting by Small and Medium Entities and in Emerging Economies' and the establishment of an advisory panel to explore SME accounting and reporting issues. FEE wrote already in December 2001 to the IASB to urge for priority for the project on accounting for SMEs.

As recognised in the preface, IASB is the international accounting standard setter whereas ISAR is not a standard setting body. Therefore IASB should issue the standard suitable for SMEs (IAS on SMEs) in addition to standards for the public interest companies.

There is a need to make IAS understandable, user friendly and easily applicable for SMEs, whose characteristics differ significantly from listed companies. For many unlisted companies some of the subjects covered by IAS would only rarely be encountered. The costs of achieving a good understanding of the accounting for such items may exceed the benefits. The disclosure requirements of IAS may be considered excessive for the users of the financial statements of smaller, privately-held companies.

Therefore, FEE sees SMEGA as an important contribution to the IASB project on accounting and financial reporting on SMEs, which should be further considered by the IASB as a possible way forward. Our comments on the SMEGA should be seen in this context.

We support the view that in the meantime the SMEGA should be guidance for national authorities to be adopted or adapted to suit their circumstances.

We first highlight some general issues, and afterwards provide specific answers to the questions raised in the document.

General Issues

Measurement and recognition principles

A fundamental question which is not explicitly addressed in the SMEGA is whether the measurement and recognition principles should be the same for SMEs or can be different. The way the SMEGA guidance is prepared, by copying mainly the bold paragraphs of the IAS implies that no significant changes have been made to the measurement and recognition principles.

The FEE position is that measurement and recognition principles should be the same for all entities. An advantage is that entities will be able to evolve more easily from level 2 to level 1. We recognise that the complexity of IAS means that there may be in few cases some questions over the cost-benefit balance and relevance of certain measurement and recognition requirements for SMEs. We are of the opinion that this issue needs to be further debated.

We agree with para 24 of the introduction that “where an entity has a transaction which falls outside the SMEGA, it is suggested that the preparer looks for guidance within the hierarchy referred to in Guideline 12’ ((a) full IAS/IFRS). In our view the application of any IAS or parts of IAS should not be restricted for SMEs.

Disclosure requirements

We believe that different disclosure requirements according to the specific needs of the users of financial statements might be reasonable for SMEs, since they usually do not have to provide information for capital markets. We therefore support a reduction in the disclosure requirements in comparison to those applicable to larger companies but retaining those requirements relevant for SMEs.

Answers to the Questions

Q1. The definitions of enterprises falling into the different levels are proposed to be left to national authorities to determine, based on the circumstances in their respective countries. ISAR has provided broad definitions of three levels. Do you consider these appropriate? Do the definitions provide enough guidance for national authorities to set their more precise boundaries?

We agree in principle with the approach of developing guidance at three different levels of complexity for businesses. However, we are of the opinion that level 1 is too strictly defined, and that level 2 is too large. The level 2 guidance would potentially embrace a very wide range of entities, including large public and private unlisted companies of considerable economic significance. Level 2 should be seen as minimum requirements and a number of level 2 entities may wish and should be encouraged to use full IAS. The “public interest” definition (page i of the Preface) needs to be elaborated and extended, in order to include mutuals, banks, insurance companies and those enterprises which are generally regarded as being of public interest.

We look forward with interest to publication by ISAR of draft Level 3 guidance on simple accrual-based accounting.

Q2. Paragraph 7 of the Preface above describes the balance that ISAR considered in determining which subjects would be covered. Do you consider that the balance struck is broadly right?

The balance struck is reasonably fair. However, ISAR needs to establish clear and robust criteria for selecting which IAS should or should not be covered in the SMEGA. FEE believes that the Level 2 guidance would be improved by having some explanation of why certain IAS were covered and others were not. This would include the rationale for selecting those and the development of the related underlying framework for SMEs - a further development of the objectives and other parts of the introduction - as well as a basis for conclusions.

Q3. Appendix 3 sets out the connection between the SMEGA's Guidelines and IASs, as well as those IASs that are not covered by the SMEGA. Guideline 12.1 describes how an enterprise using the guidance should deal with subjects not covered by the SMEGA. Are there any subjects covered in the SMEGA that, in your opinion, need not be included? Are there any subjects that are not covered that, in your opinion, should be included?

FEE agrees to the compulsory reference (in Guideline 12) to full IAS in case a subject is not covered by SMEGA. However, some additional subjects might beincluded.

As regards the standards dealing with consolidation issues, as group structures may vary from country to country, it seems sensible to add:

- A principle that where a company has subsidiaries consolidated accounts should be expected in line with IAS 27.

- An annex of the level 2 approach applied to consolidations which could be included or otherwise by national authorities.

Concerning sectoral standards, we recommend the inclusion of construction contracts. There are more level 2 than level 1 constructors. Investment property and agriculture would also depend on judgements of how frequently these will be relevant, but they would seem adequately covered by the principle of looking to the full IAS when relevant.

As far as standards of general application are concerned, we suggest the inclusion of extracts of limited sections of IAS 39 and IAS19 to cover the "straightforward" accounting for commonly occurring financial instruments (e.g. trade receivables, trade payables, bank borrowings) and employee benefits (costs other than defined benefit pensions).

Q4. Paragraph 7 also applies to the balance between length of the guidance and the amount of explanatory material provided in support of the treatments set out in the Guidelines and in Appendix 2. Do you consider that the balance struck is broadly right? Or do you consider the guidance too detailed? Or should the examples and other explanatory material be expanded?

The balance between the need for brevity and usability and the need to be comprehensive and to provide sufficient explanation appears reasonable. However, there seem to be some areas where more explanation out of full IAS might be appropriate, including:

- Paragraph 2.7(b) is not entirely clear as such and possibly open for misunderstanding without including IAS 7.23 in the SMEGA
- Paragraph 3.25 refers to cash generating unit. This term needs to be defined in Appendix 1

- Worked examples to help illustrate in Guideline 4 rate implicit in the lease, sale and leaseback, incentives in leases
- Guideline 4 should mention that it does not deal with lessor accounting
- Paragraph 5.8 clarification of treatment of purchased titles, brands, customer lists etc.
- Paragraph 8.9 which could be taken to mean that discounting to present value would be needed, even though no guidance is given and the note in Appendix 3 implies none is required.

Q5. Do you have any comments on the future review and updating of the SMEGA?

FEE believes SMEGA should be updated regularly, reflecting the changes/improvements made to full IAS by IASB as well as ameliorating the text of the guidance based on experience with the SMEGA, in absence of an IAS on SMEs (see page one of this letter).

Q6. Is the SMEGA likely to be a useful document in your country or region?

For Europe we see the principal usefulness of the SMEGA in contributing to the IASB SME project and in accelerating this process. In absence of an IAS for SMEs, some national standard setters in Europe might find the SMEGA a useful base for developing their own standards for SMEs. Moreover, we believe that the SMEGA can be of direct use in developing countries and economies in transition in absence of national standards/guidance and awaiting the IAS for SMEs.

Q7. Is there other material, or are there other changes to the format of the SMEGA that could help improve the guidance and make it more usable?

In order to assist national authorities the guidance could highlight the alternative treatments included and where national authorities might choose to eliminate one of the options. For instance:

- revaluation of property, plant and equipment in paragraphs 3.10 to 3.18,
- intangibles in 5.12
- borrowing costs (para 10.2)
- deferred tax (para 11.4)

We would be pleased to discuss any aspect of this letter you may wish to raise with us.

Yours sincerely,

David Devlin
President