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Le Président

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Dear Mr. Enevoldsen,

Re: FEE Response to EFRAG Draft response to IASB Questionnaire on Possible recognition and Measurement Modifications for SMEs

1. EFRAG's preliminary views on the IASB Questionnaire on SMEs have been very helpful to us in our discussion of the document. We are pleased to submit FEE's comments on EFRAG's preliminary views. Our response focuses on those issues where we are in disagreement or where we have additional views to present.

2. We share your concerns that IASB might arrive at only few differences on recognition and measurement for SME standards from existing IFRS. We believe there should be as many differences as are necessary to meet the needs of users of SME financial statements and to provide sufficient simplification compared to "full IFRS".

3. We recall that the IASB may set standards for SMEs, but that it is for national jurisdictions, or regional regulators such as the EC, to decide if and which entities are required or allowed to apply such international standards. Nevertheless, it is important that the IASB develops the standards for the SMEs with certain entity characteristics in mind. The crucial issue is that international standards for SMEs should be sufficiently simplified (also resulting in a substantially less voluminous book that SMEs will have to cope with).

4. We recognise the need for EFRAG to fix a target size of entities to have a proper focus in its answer to the questionnaire. We agree with EFRAG that the focus should be on medium size entities. However, we recommend EFRAG not using the size criteria of the Seventh Directive in its argument but rather link this to the paragraph above (third paragraph) on national jurisdiction liberty to decide on the application of the SME standards. The focus should be on the characteristics of entities and on user needs rather than on the size, acknowledging that the IASB needs to develop the standards for SMEs with a certain size in mind.

5. We are of the opinion that EFRAG should address in its letter to the IASB the issue of elimination or reduction of options for recognition and measurement. In principle, standards for SMEs should be without options, with exemptions for those options that could benefit for SMEs. In that case the option should be briefly described in the standard, but the SME would have to refer to the full IFRS text if it wants to apply the option.

6. The IASB questionnaire does not address IFRIC Interpretations. We are of the opinion that EFRAG should advise IASB to also address Interpretations as part of its simplification project.

7. The conclusion of the second bullet point on page 2 (Measurement bases…) appears to us not to be clearly linked to the arguments above. The market values have less relevance to SME users because they want to assess primarily the ability to generate cash flows, not only to assess the quality of management. We suggest moving the first bullet point of page 2 within the second one.

8. We recommend revising the commentary listing the type of users of SME that are not covered (page 3, second bullet point). Depending on the legal environment, users of SME financial statements would include employee representative groups, which can have as much expertise as employee groups of a listed company. EFRAG could change the text to "users *generally* tend not to include" or delete the reference to employee representative groups. Also, credit rating agencies are users of SME accounts and refer to them extensively.

9. As part of the comments received by IASB on its 2004 discussion paper, the European Accounting Association's Financial Reporting Standards Committee has submitted a review of research by European academics relevant to the IASB project on SMEs, notably on user needs. EFRAG may find it useful to refer to this document in preparing its comment letter.

Question 1 – What are the areas for possible simplification of recognition and measurement principles for SMEs?

1. <u>Relevance of fair value concept</u>

1. We consider that EFRAG needs to indicate that the overall principle for SMEs is historical cost. The use in certain circumstances of fair value should be an exception to this overall principle. Where this exception is applied in form of granting an option to SMEs it should only be summarised in the standards for SMEs (SMEs that wish to apply the option will need to refer to the full text of the IFRS concerned).

2. We recognise that EFRAG needs to have criteria in selecting which fair value measurement options need to be retained in the standards for SMEs and could accept the criteria it identified of:
   - Observable market data is available.
   - Either the asset can be sold on the market at any time without causing any disruption or major change in the entity's operations or the management is committed to a plan to sell the asset and an active programme to locate a buyer and complete the plan have been initiated.

   However, these criteria should <u>not</u> be used in the standards themselves to restrict the definition or the application of fair value, nor should a new definition of fair value be (implicitly) introduced. This use of the criteria needs to be further explained in the EFRAG letter.

3. Furthermore it is not clear in the EFRAG response when and why fair value measures would be permitted and when and why they would be required.

4. It is confusing to refer to the two criteria to select appropriate fair value measurements for SMEs as "easily disposable assets".

5. Using wording like "any disruption or major change", "management is committed to a plan to sell", in the second criterion, is rather vague and we would prefer more precise wording.

6. IAS 39: We support the EFRAG proposal to use only two categories of financial assets, and to recognise the gain/loss immediately in the profit and loss account. However, with this proposal, one should make sure that held to maturity assets would not be recognised differently in an SME than in a listed entity.

7. IAS 16 / IAS 38: The text of the EFRAG comment letter needs to be adapted to indicate that based on the two criteria EFRAG has decided that the fair value measurement should be kept for SMEs. This should be without entering these criteria into the standard for SMEs itself.

8. We note that IAS 40 is not mentioned by EFRAG in the analysis on page 5. The principle should be historical cost. If SMEs wish to revalue investment property they need to apply “full IAS 40”.

9. IAS 27/IAS 28/IAS 31:The EFRAG letter needs to highlight that the overall principle is historical cost for SMEs. The options, for fair value, if retained, should be summarised. If SMEs want to apply the option they need to refer back to the full standard. If the fair value option is kept, EFRAG should elaborate on its proposal and also specify if the fair value adjustment would be recognised in the profit and loss account or in equity, in accordance with IAS 39.

10. IFRS 5: We agree with EFRAG to omit the measurement provisions in this standard for SMEs, for practical reasons, and to incorporate the relevant principles in other standards. This standard in itself is too complex to apply.

2. <u>Simplifications based on cost-benefit arguments</u>

11. IAS 38: We agree with EFRAG’s suggestion to permit expensing developments costs in all circumstances, even where the criteria for capitalisation are met. We believe that the only intangible assets EFRAG addresses are development costs and we could not think of another example of intangibles assets that would meet the criteria for capitalisation. We suggest EFRAG limit the option to development costs. If the standard for SMEs still includes the option to expense other intangible assets, examples need to be given of such intangible assets. Introducing an option to expense all development costs is a valid proposal as in some cases it is difficult and burdensome for SME to justify the capitalisation of development costs. However, we do not support the proposal to disclose the amounts expensed because it adds an extra burden for preparers if the amount is to be separately disclosed.

12. IFRS 3: We agree with EFRAG to reintroduce amortisation with an impairment test only when indication of impairment arises. Although it does not produce more relevant information than the “impairment test only model”, the compliance costs are reduced. However, the 20 years amortization period proposed is seen as arbitrary and there is no rationale behind EFRAG’s suggestion. We propose that it should instead be a rebuttable presumption of a 20 years maximum period.

13. IFRS 5: We agree with EFRAG that the measurement provisions of IFRS 5 are superfluous for SME standards.

14. IAS 36: We agree with EFRAG. We suggest that EFRAG propose a way to reduce the burden of calculating impairment for SMEs. The current impairment test under IAS 36 is very complex to apply. IAS 36 requirements could be a basic guideline for a simplified and more straightforward test. However, we think that the general principle of impairment is an important one. If the recoverable amount of an asset is lower than its carrying amount, this should be reflected as an impairment loss.

15. IAS 38: We agree with EFRAG’s proposal to eliminate the distinction between intangible assets with indefinite life and with definite life and also suggest amortisation of intangible assets, including a rebuttable presumption of the 20 year maximum period.

16. IAS 39: We agree that SME could be permitted to apply either effective interest method or straight line method.

17. IAS 17: Unlike EFRAG we wish to allow SMEs to expense all leases, with disclosures of leases commitments, for simplification on cost-benefit ground.

18. IAS 40: The EFRAG comment is referring to paragraph 25 of IAS 40. We feel the suggestion of EFRAG to always measure investment property at present value of the minimum payments is unfounded because the principle of lower of cost and fair value should still be applied. The

impairment will reduce any overstatement. We disagree with EFRAG and prefer to keep the investment property at the lower of fair value and present value of the minimum lease payments.

3. Simplifications because transactions are unlikely to occur in an SME context or the complexity of the transactions require application of the full IFRS standard

19. IAS 39: We do not agree with EFRAG's simplification of hedge accounting rules limited to foreign currency risks because it is now common for an SME to enter into hedge of interest rate risks, specially within the Euro zone. We believe that when SMEs enter into the complex issue of financial instruments they have to apply the full IAS 39 standard. However, if hedge accounting for SMEs is simplified, it should be in the context of the administrative burden related to the documentation and the effectiveness testing.

20. IFRS 2: We agree with EFRAG that a simplified standard on share-based payments is needed since SMEs have share-based payments and the current IFRS 2 is focused on listed entities.

4. No simplification on recognition and measurement identified:

We agree with EFRAG that no simplification is required for:

IAS 2 Inventory,
IAS 8 Accounting Policies, changes in accounting estimates and errors,
IAS 10 Events after the balance sheet date,
IAS 11 Construction contracts,
IAS 18 Revenue,
IAS 19 Employee benefits
IAS 20 Government Grants,
IAS 21 Effects of changes in foreign exchange rates,
IAS 27 Consolidated and separated financial statements,
Equity method under IAS 28 and IAS 31,
IAS 29 Financial reporting in hyperinflationary economies,
IAS 31 Interest in Joint Ventures
IAS 32 Financial instruments: disclosure and presentation,
IAS 37 Provisions, Contingent Liabilities and contingent assets,
IAS 41 Agriculture,
IFRS 6 Exploration and Evaluation of Mineral Resources.

Deferred income tax accounting under IAS 12: We do not agree to retain the deferred taxes accounting principles for SME because of its complexity. We would favour a simplified tax accounting method (cash flow through method).

Derecognition principles under IAS 39: We agree with EFRAG that the basic principles on derecognition should be retained, except for the fair value measurement of the guarantee given in case of continuing involvement.

Question 2: From your experience, please indicate which topics addressed in IFRSs might be omitted from SME Standards because they are unlikely to occur in an SME context. If they occur, the standards would require the SME to determine its appropriate accounting policy by looking to the applicable IFRS.

IFRS 2: We agree with EFRAG.

IFRS 3: We agree with EFRAG. There is no reason to assume that SME will seldom enter into business combinations. Therefore an appropriate SME standard on business combinations is necessary.

IFRS 4: We disagree with EFRAG because we agree that companies that issue insurance contracts have public accountability and should follow full IFRS.

IAS 11 Combining and Segmenting Construction Contracts: We agree with EFRAG. IAS 11 accounting principles should be retained for SMEs.

IAS 12 Temporary differences: We agree with EFRAG to retain these principles.

IAS 16 Revaluation model for property, plant and equipment: we refer to response to Question 1 of this letter.

IAS 17 Sale and leaseback transactions: We agree with EFRAG to retain the principles for SMEs.

IAS 19 Defined benefit employee programmes: We agree with EFRAG but prefer that for other long-term plans, the requirements are simplified.

IAS 23 Capitalisation model for borrowing costs: We agree with EFRAG to omit the topic for SMEs.

IAS 26: We agree with EFRAG and IASB.

IAS 27: We agree with EFRAG that the principles in IAS 27 should be part of the SME standards.

IAS 30: We agree with IASB that financial institutions have public accountability.

IAS 32 Split accounting for compound financial instruments: We agree with EFRAG and agree to maintain the topic.

IAS 36 Impairment of goodwill: We agree with EFRAG and disagree to omit this topic for SMEs.

IAS 38 Revaluation model for intangibles: we refer to response to Question 1 of this letter.

IAS 39 Derecognition: We agree with EFRAG.

IAS 39 Hedge accounting: We disagree with EFRAG and prefer a full fallback to IAS 39.

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

Yours sincerely,

David Devlin
President