

February 1, 2006

Tom Jones
IASB
30 Cannon Street
London EC4M 6XH
UK

Dear Tom,

Re: IASB SME Project

As you know, most stakeholders in Europe have high expectations of the SME project and is therefore following it closely and is very keen to do everything it can to help ensure that it succeeds. We therefore very much appreciate the big efforts the IASB is putting into this project. We also appreciate that the project is somewhat different from the mainstream work of the IASB, and therefore requires a different line of thinking which might be seen as taking time away from your other activities.

EFRAG wants to express its full support for the comments you made in your introduction to the Board's deliberations at the January meeting where you indicated that:

- (a) the direction in which the project is presently heading under Board members guidance is leading to a standard which appears far too lengthy and complex; and
- (b) more simplifications are needed than decided up to date in order to meet constituents' expectations

We agree with this view. We think it is important that the IFRS for SMEs is easy to understand and comprehensive on a stand-alone basis. We set out below a suggestion which we hope can help the staff and the IASB find a route that is acceptable to the vast majority, without causing unnecessary delay to the project.

Suggestion

To meet constituents' expectations, the approach to and structure of the SME standard needs to be changed

One reason why the first draft of an ED appears lengthy and complex is that staff seems to be sticking very closely to full IFRS. This is making it difficult to achieve an important objective in this SME project, which is to make the accounting requirements easy to understand. It is clear that at least some IASB Board members recognise this problem.

The need for pervasive principles has been discussed at length by the Board and we strongly support the need for such principles. We would though suggest that they are deeply rooted throughout the standard—rather than just in the introduction—and written in a way so that

they would each apply to a broad range of assets and liabilities. To identify those principles and still remain close to IFRS, we would recommend that the following approach is adopted:

- 1 Keep the top-down approach until all necessary simplifications have been identified.
- 2 Once the further simplifications needed have been identified, identify to what extent there are common principles among broad categories of assets, financial liabilities and non financial liabilities, in the areas of:
 - (a) measurement on initial recognition,
 - (b) subsequent remeasurement and depreciation/amortisation,
 - (c) how to determine cost (of acquisition, of production),
 - (d) how to estimate fair value, and
 - (e) derecognition.
- 3 Organise the material so that each section applies to as wide a range of assets and liabilities as possible, so as to:
 - (a) emphasise the existence of common basic principles (and the rationale for retaining them),
 - (b) avoid duplication and repetition, and
 - (c) deal with the detailed requirements that apply to certain categories of assets and liabilities within the broad categories, but under the specific assets or liabilities concerned.

We think such an approach would have the following major advantages over the existing approach:

- It would make the standard much more concise and easy to understand than the existing IFRS and the draft ED
- It would ensure that the SME standard does not become the 'endless list of requirements' type of standard that favours a rule-based attitude.
- It would put the SME standard on a more independent basis. The standard would be firmly based on fully justified principles taken from full IFRS, but would not necessarily need to be changed as future amendments to full IFRS are published.

To meet constituents' expectations, more simplifications are needed

It is clear that the tentative decisions taken by the Board in November and December have generated general disappointment among stakeholders in the SME environment. We too are disappointed. In our view the Board should be asking itself how SMEs could reach a similar presentation to listed entities—including a similar level of relevance and reliability— but in a less sophisticated manner.

We therefore suggest that the Board considers again some of the simplifications recommended earlier in EFRAG's response to the questionnaire asking for possible recognition and measurement simplifications. In particular:

- 1 EFRAG's approach to the use of fair value in an SME context should be considered for both financial and non-financial assets (except for inventory). We agree that pension assets and derivatives should be measured at fair value, and our detailed suggestion is not in our view inconsistent with the Board's current position on the use of fair value by listed entities.
- 2 Amortisation of goodwill and of indefinite life intangible assets should be re-instated for SMEs to reduce the burden on SMEs whilst at the same time ensuring that such assets are not left untouched on the balance sheet.
- 3 The requirement to recognise separate intangible assets on an acquisition should be eased to allow more intangibles to be 'lumped in' with goodwill. (In particular, acquirers should not be required to recognise intangible assets not recognised previously by the acquiree.) This would reduce the complexity and implementation burden. The requirements for recognition and measurement in an acquisition should also be eased to allow a greater degree of approximation and, as a result, reduce the complexity and burdens on SMEs.
- 4 Expensing of development costs (and borrowing costs) should be permitted.
- 5 SMEs should be permitted to use intrinsic value measurement at exercise date in all circumstances to account for share-based payments. Furthermore, making the exception available for equity settled SBP the principle for all SBP would greatly increase the understandability of the section of the standard dealing with SBP.

The Board has decided to undertake further work to try to identify simplifications in the areas of income taxes, post-employment benefits and leases. We support this decision, although we also continue to believe that all liabilities should be shown on the balance sheet of an SME.

Some further open debate is needed in areas where the Board and staff have identified work still to be done

At your January meeting the staff told the Board that there were a number of issues that it still needed to discuss. These issues, in our view, should include:

- (a) principles need to be set in order to select what disclosures need to be retained (or newly required) for SMEs. This should be carried out with the specific needs of SME financial statements users in mind;
- (b) presentation requirements, and standards such as IAS 8, need to be debated;
- (c) future evolutions of IFRS for SME need to follow a well defined policy; the adequacy of a revised framework to SMEs, in particular in the area of measurement, should not be taken for granted;
- (d) the hierarchy applicable when a transaction is not specified in the IFRS for SME should be decided in the context of a stand-alone IFRS for SME;
- (e) the reduction of available options should be considered both in the context of the need for simplification and the appropriateness of removing options that are still available for listed companies that are complying with full IFRS.

If you would like further clarification of the points raised in this letter or have any questions Françoise Flores and I would be happy to discuss them further with you.

Kind regards,

Stig Enevoldsen
EFRAG, Chairman

Françoise Flores
EFRAG member,
co-chair of the European joint working group
on SME accounting

cc Sir David Tweedie, chairman, IASB
cc Alexander Schaub, Director General, European Commission