EUROPEAN COMMISSIO
Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COM
Financial reporting

DIRECTORATE GENERAL FOR INTERNAL MARKET AND SERVICES

CONSULTATION ON THE INTERNATIONAL FINANCIAL REPORTING STANDARD FOR SMALL AND MEDIUM-SIZED ENTITIES

The European Commission is seeking the views of stakeholders on the IFRS for SMEs. Comments will assist DG Internal Market and Services in its ongoing review of the 4th and 7th Company Law Directives (The Accounting Directives).

Stakeholders are invited to comment on the questions raised in this Consultation Paper by completing the **response sheet in this linked document**, and emailing it by 12th March 2010 to the following email address: **markt-review-consultation@ec.europa.eu**. Respondents may alternatively send comments by post to the European Commission, DG Internal Market and Services, Financial Reporting Unit-F3, SPA 2/JII - 01/112, B-1049 Brussels, Belgium.

Contributions received, together with the identity of the contributor, will be published on the Internet, unless the contributor objects to publication of personal data on the grounds that such publication would harm his or her legitimate interests. In this case the contribution may be published in anonymous form. Otherwise the contribution will not be published nor will, in principle, its content be taken into account. Please read the specific privacy statement applying to this consultation for information on how your personal data and contribution will be dealt with.

In the interests of transparency, organisations are invited to provide the public with relevant information about themselves by registering in the Interest Representative Register and subscribing to its Code of Conduct. If the organisation is not registered, the submission is published separately from the registered organisations (Consultation Standards, see COM (2002) 704, and Communication on ETI Follow-up, see COM (2007) 127 of 21/03/2007).

November 2009

Commission européenne, B-1049 Bruxelles / Europese Commissie, B-1049 Brussel - Belgium. Telephone: (32-2) 29 65 199.

http://ec.europa.eu/internal_market/accounting/sme_accounting/review_directives_en.htm
E-mail: markt-f3@ec.europa.eu

Please provide the following details together with your response:

You are:

Preparer:	☐ small company ☐ medium-sized company ☐ large company	☐ Other (please specify)	Legal Form ☐ unlimited liability ☐ limited liability
User:	☐ bank/credit provider	☐ analyst	☐ other organisation of stakeholders
	☐ private person	☐ investor/investor organisation	
Public authority:	☐ audit/market regulator	☐ Government Ministry/Agency	☐ other (please specify)
Accountants and Auditors:	☐ accounting firm	☐ audit firm	☐ organisation of accountants and auditors
Other:	☐ (please specify)	……………………………………………………	

Name of your organisation / company: ……..……………………………………….

Country where your organisation / company is located: …… …………...…………..….

Name and location of parent company (if applicable)…

Contact details incl. e-mail address…

Short description of the general activity of your organisation / company: …………

Do you trade cross-border? ☐ Yes ☐ No

Is your organisation registered in the Interest Representative Register? ☐ Yes ☐ No

If yes, please specify the address of your organisation and the Register ID number in the Interest Representative Register[1]: ……………………..

Publication:

Do you object to publication of the personal data on the grounds that such publication would harm your legitimate interests? ☐ I object

[1] If your organisation is not registered, you have the opportunity to register here (https://webgate.ec.europa.eu/transparency/regrin/welcome.do?locale=en#en) before you submit your contribution. Responses from organisations not registered will be published separately from the registered organisations.

1. OBJECTIVE OF THE CONSULTATION

The objective of this consultation is to gain an understanding of EU stakeholders' views on the International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs). The Commission is especially interested to receive comments from the users of accounts, such as business, banks and investors.

Comments will be analysed and will assist DG Internal Market and Services in its ongoing review of the Accounting Directives.

2. BACKGROUND

Since 2005 companies listed in the EU (and companies whose debt securities are listed in the EU) have had to prepare their consolidated financial statements in accordance with EU endorsed IFRS[2]. The "IAS regulation" gives Member States the options of extending the IFRS requirement to other companies, or allowing other companies to voluntarily adopt IFRS.

It is understood that relatively few companies have voluntarily chosen to adopt IFRS (where permitted), and few Member States have required mandatory adoption for non-listed companies[3]. Commentators have cited the complexity and length of IFRS accounts as being major reasons for the relatively low adoption rate.

The vast majority of EU companies, therefore, continue to prepare their accounts in accordance with Member State generally accepted accounting practice (GAAP) which is in accordance with the Fourth[4] and Seventh[5] Company Law Directives. These two Directives provide a common set of accounting principles, prescribed layouts for the profit and loss account and balance sheet and a set of minimum disclosures by way of notes to the accounts. However there are numerous Member State options and significant amounts of "gold plating" (where Member States add in further requirements at a national level) so comparison of financial statements from one country to another is not always possible. Whilst the Directives currently contain a number of exemptions for SMEs, there are a number of requirements in the Directives that create unnecessary burdens, especially for small companies. Commissioner McCreevy announced in a public statement on 29 September 2008 that a review of the Fourth and Seventh Directives should take place[6] to see how the Directives could be amended to reduce the administrative burden on SMEs.

After the aforementioned declaration the Commission started to work on modernising and simplifying the Accounting Directives. A public consultation ran

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2 Regulation on the application of international accounting standards (1606/2002/EC)

3 Report on the operation of Regulation (EC) No 1606/2002 19 July 2002 on the application of international accounting standards

4 Fourth Council Directive (78/660/EEC)

5 Seventh Council Directive (83/349/EEC)

6 See:EUROPA - Press Releases - McCreevy announces major initiatives on accounting rules for small businesses

between 25 February and 30 April 2009[7]. A number of respondents raised the issue of the then forthcoming IFRS for SMEs, some commenting that the Directives should allow its adoption, others stated that there was no further need for the EU accounting regime to further align with International Accounting Standards.

The IFRS for SMEs was published in its final form on 9th July 2009. This consultation exercise is intended to gather the views of EU stakeholders on the final Standard. DG Enterprise and Industry is also undertaking a study into accounting requirements for SMEs and the results of both this consultation and the study will inform the outcome of the Directives' review project.

3. A BRIEF SUMMARY OF THE IFRS FOR SMEs

The IFRS for SMEs is a 230-page standard tailored to the needs and capabilities of smaller businesses. Many of the principles in full IFRS for recognising and measuring assets, liabilities, income, and expenses have been simplified; topics not relevant to SMEs have been omitted; and the number of required disclosures has been significantly reduced. It is a "stand-alone" standard with the exception of one "fallback" option to full IFRS; that is an option to use IAS 39[8] to recognise and measure all financial instrument transactions, but their disclosure must be in accordance with the IFRS for SMEs, not IAS 32[9] or IFRS 7[10].

The Standard can be used by any entity that does not have public accountability. Listed companies and financial institutions are publicly accountable and are precluded from using it. Subsidiaries of listed companies will be able to use the Standard provided they themselves are not publicly accountable.

The Standard is arranged into 35 chapters. These cover:

(1) Concepts and pervasive principles – These are drawn from the "Framework"[11] that exists in full IFRS. The principles underpin the accounting treatments required by the Standard, and where a transaction or arrangement is not addressed within the Standard a preparer should refer to them in deciding how it should be accounted for.

(2) The financial statements that should be presented – these are (i) a statement of financial position (balance sheet), (ii) a statement of comprehensive income and an income statement (profit and loss account), (iii) a statement of changes in equity (reserves statement), (iv) a cash flow statement.

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[7] See: European Commission » Internal Market » Consultation on the Review of the Fourth and Seventh Company Law Directives

[8] IAS 39 – Financial Instruments: recognition and measurement

[9] IAS 32 – Financial Instruments: presentation

[10] IFRS 7 – Financial Instruments: disclosures

[11] Framework for the preparation and presentation of financial statements

Additional information on the items disclosed in the various financial statements must also be provided by way of notes.

(3) The detailed guidance on how to account for particular arrangements and transactions - Accounting treatments are outlined for most issues addressed by full IFRS, except for those particularly relevant to listed entities, such as segmental reporting, interim reporting and earnings per share disclosures.

There is a "mixed measurement" model within the Standard, in that historic cost is required for certain transactions, fair value is required for others and sometimes a choice is allowed. For instance, property, plant and equipment, acquired intangible assets and most basic financial instruments are valued on a cost basis. Holdings of quoted equities, complex financial instruments (such as convertibles, options, forwards and swaps), investment property, and biological assets (growing crops or livestock) are measured on a fair value basis. Investments in associates and joint ventures may be measured at cost, fair value (or equity accounted).

Where a fair value measurement is required but cannot be established without undue cost or effort an alternative measure of cost is generally permitted.

A more detailed summary of the Standard is given in the Appendix to this consultation paper. The full Standard, Basis for Conclusions and Illustrative Financial Statements are available on the IASB website[12].

4. SPECIFIC ISSUES

4.1 Initial reaction to the Standard

Some commentators have expressed the view that the IFRS for SMEs will allow international comparison of financial statements and that may lead *inter alia* to increased access to finance, reductions in the cost of capital, increased trade, and increased levels of cross-border merger and acquisition activity. International groups that are eligible to use it may see compliance costs fall and increased information usefulness from dispensing with different local reporting regimes.

Others have questioned whether the Standard is too complex for small businesses and whether it is too much of a simplification for the largest businesses eligible to use it. The cost of changing accounting systems and training staff has been raised as an issue also, as has the effect on tax liabilities in making the transition from local GAAP to the Standard. In countries where there is presently close alignment of tax and accounting some have questioned whether adopting the Standard would increase compliance burdens rather than reduce them? Other concerns raised include the possible effect on distributable reserves, the further proliferation of accounting regimes that it brings and whether audit choice will be reduced because the international audit firms have experience of auditing IFRS accounts and may be better positioned than smaller firms of auditors when it comes to auditing IFRS for SMEs accounts.

12 IFRS for SMEshttp://www.iasb.org/IFRS+for+SMEs/IFRS+for+SMEs.htm

Question 1:
Do you think the IFRS for SMEs is suitable for widespread use within Europe?

☐ *YES* ☐ *NO* ☐ *Don't know*

Please comment, indicating whether there are any type(s) or size(s) of company that would benefit from adopting the Standard:
……………………………………………………………………………………

☐ *small*[13]

☐ *medium*[14]

☐ *large*[15]

☐ *other criteria (please explain)*

Question 2:
If you are a preparer of company accounts can you indicate any costs (both one-off and recurring) or benefits, and any other effects of adopting the IFRS for SMEs?

Please comment………………………………………………………

In particular, do you think increased international comparability of accounts prepared under the IFRS for SMEs will benefit your business?

☐ *YES* ☐ *NO* ☐ *Don't know*

Please comment……………………………………………………

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[13] Generally companies with turnover less than €4.4 million, balance sheet total less than €8.8 million and 50 or fewer employees (see Fourth Company Law Directive)

[14] Generally companies with turnover less than €17.5 million, balance sheet total less than €35 million and 250 or fewer employees (see Fourth Company Law Directive)

[15] Generally companies with turnover greater than €17.5 million, balance sheet total greater than €35 million and more than 250 employees (see Fourth Company Law Directive)

Question 3:
If you are a user of accounts (for example a bank) do you think the IFRS for SMEs will provide more useful information than national GAAP accounts?

☐ *YES* ☐ *NO* ☐ *Don't know*

Please comment……………………………………………………..

Question 4:
Does increased international comparability of accounts prepared under the IFRS for SMEs benefit users?

☐ *YES* ☐ *NO* ☐ *Don't know*

Please comment………………………………………………………

4.2 Possible use in Europe

Company accounts must comply with the requirements of the Accounting Directives, as enacted into national law. The Commission Services are still working with EFRAG and other experts to analyse whether there are material differences between the Accounting Directives and the IFRS for SMEs, which could result in companies being precluded from adopting the Standard.[16]

Where inconsistencies are identified in the current or future versions of the Standard (the IASB has committed to a review in 2011, and every three years thereafter) there are questions over how they should be dealt with.

Question 5:
Do you think adoption of the IFRS for SMEs should be provided for within the EU accounting legal framework?

☐ *YES* ☐ *NO* ☐ *Don't know*

Please comment………………………………………………………

[16] In EU, companies could nevertheless in any case prepare their accounts according to IFRS for SMEs on voluntary basis in addition to statutory accounts prepared in accordance with the Directives.

Question 6:
If yes, should such an option be limited to a Member State option (i.e. that each Member States would have a possibility but no obligation to accept IFRS for SME)?

☐ *YES* ☐ *NO* ☐ *Don't know*

Please comment.………………………………………………….

Question 7:
Do you have other views on the possible adoption of the IFRS for SMEs within the EU accounting framework?

Please comment.………………………………………………….

Question 8:
Is there a case for giving companies, at EU level, an option to adopt the IFRS for SMEs?

☐ *YES* ☐ *NO* ☐ *Don't know*

If yes, for which categories:

☐ *small*

☐ *medium*

☐ *large*

☐ *other criteria (please explain)*

Please comment.……………………………………………………….

Question 9:
What should be done, in your view, where there is incompatibility between the Directives and the IFRS for SMEs?

Please comment.………………………………………………….

4.3 The role and content of the Directives

In addition to the fundamental accounting principles, the present Directives include many accounting "rules" with the Fourth Directive, for instance, including prescriptive formats for the primary financial statements in Sections 3 and 5, valuation rules in Sections 7 and 7a and the notes disclosures in Section 8. The overhaul is already committed to modernising and streamlining the content of the Directives, but some have said that the publication of the IFRS for SMEs provides an opportunity to create a shorter Directive that would set out only the following main principles:

(1) Fundamental principles

(2) The primary financial Statements to be produced, and basic layouts

(3) The content of the annual/management report and governance disclosures

(4) Publication requirements

(5) The requirement for audit

National standard setters could then set the detailed accounting requirements for preparing annual accounts at member state level, or possibly use the IFRS for SMEs locally provided there is no incompatibility with the Directives.

The IFRS for SMEs includes detailed guidance on certain areas of accounting where the Directives presently provide little, for instance lease accounting and share-based payments. If the Directives are to retain their "rules-based" content there may be a case for adding sections on accounting issues addressed in the IFRS for SMEs, but not the present Directives.

Question 10:
In the light of the publication of the IFRS for SMEs, do you see a need for "rules-based" Accounting Directives in the future?

☐ *YES* ☐ *NO* ☐ *Don't know*

If yes, for what type(s) or size(s) of company are detailed rules required?

☐ *small*

☐ *medium*

☐ *large*

☐ *other criteria (please explain)*

Other than the 5 items listed in paragraph 4.3 above, what aspects of financial reporting should the revised Directives address, and to what level of detail……………………..?

Other comments……………………………………….

Question 11:
Are there any elements of the IFRS for SMEs that should be incorporated within revised Directives?

Please comment……………………………………………………….

Question 12:
Do you have any other observations or comments on the IFRS for SMEs or the project to overhaul the Accounting Directives?

Please comment……………………………………………………….

Thank you for your contribution

Appendix

A Summary of the IFRS for SMEs

Section 1: Small and Medium-sized Entities - The standard is applicable to non-publicly accountable entities publishing general purpose financial statements.

Section 2: Concepts and Pervasive Principles – The objective of financial statements is to provide information about the financial position, performance and cash flows of an entity.

The qualitative characteristics of information in financial statements are understandability, relevance, materiality, reliability, substance over form, prudence, completeness, comparability, timeliness and the balance between benefit and cost.

At initial recognition, assets and liabilities are measured at historical cost unless the standard requires fair value.

Section 3: Financial Statement presentation – Financial statements should be fairly presented, and are made up of:

- A statement of financial position
- A single statement of comprehensive income or a separate income statement and statement of comprehensive income
- A statement of changes in equity
- A Statement of cash flows
- Notes to the financial statements

Section 4: Statement of Financial Position – This can also be referred to as a "balance sheet". Information should be presented on a current/non–current basis unless a liquidity approach is more relevant/reliable.

Section 5: Statement of Comprehensive Income and Income Statement – Preparers have a choice between presenting a separate statement of comprehensive income and a separate income statement, or a single combined statement of comprehensive income.

Minimum presentation requirements are set out, and expenses may be presented by nature or function. No income or expenditure items may be described as "extraordinary".

Section 6: Statement of Changes in Equity – This includes total comprehensive income, investments by owners, distributions to owners and treasury share transactions. Where only dividends are paid, a simpler Statement of income and retained earnings can be presented.

Section 7: Statement of Cash Flows – This presents operating, investing and financing cash flows, with an option to use either a direct or an indirect method to present operating cash flows.

Section 8: Notes to the Financial Statements – These disclose significant accounting policies, information about judgements and estimations, together with other supporting information for items shown in the primary financial statements.

Section 9: Consolidated and Separate Financial Statements – Consolidated accounts should generally be prepared where a parent controls a subsidiary or special purpose entity. Separate financial statements need not be prepared.

Section 10: Accounting Policies, Estimates and Errors – This section provides guidance on the selection and application of accounting policies. Voluntary changes in accounting policy and correction of prior period errors are applied retrospectively, whilst changes in accounting estimates are applied prospectively.

Section 11: Basic Financial Instruments – With the exception of quoted equities, basic financial instruments are measured at amortised cost using the effective interest method. Impairment losses should be recognised in profit or loss, and should be reversed if the conditions giving rise to the impairment no longer exist.

A financial asset is generally derecognised when the risks and rewards of ownership are transferred to another entity.

Section 12: Other Financial Instruments Issues – Complex financial instruments are measured at fair value through profit or loss (FVTPL). Hedge accounting is allowed in prescribed circumstances.

There is an option to recognise and measure financial instruments in accordance with IAS 39 instead of using the criteria set out in Sections 11 and 12 of the IFRS for SMEs. Disclosure must be in accordance with the IFRS for SMEs, not IAS 32 or IFRS 7.

Section 13: Inventories – These are measured at the lower of (i) cost and (ii) selling price less costs to complete and sell. Weighted average cost and FIFO measures are allowed. LIFO is not permitted.

Section 14: Investments in Associates – These are measured at either cost, or the value of the investor's share of net assets (the equity method) or FVTPL.

Section 15: Joint ventures – These are measured on the same basis as Associates.

Section 16: Investment Property – Investment property is measured at FVTPL where a reliable estimate of fair value can be made without undue cost or effort. Otherwise it should be accounted for as property, plant and equipment.

Section 17: Property Plant and Equipment (PPE) – PPE is measured at cost less accumulated depreciation and accumulated impairment losses. Revaluations are not permitted. Borrowing costs may not be capitalised.

Section 18: Intangible Assets other than Goodwill – These are generally measured at cost less accumulated amortisation and accumulated impairment losses. An intangible asset should be amortised over its useful life, or 10 years if a reliable estimate of its useful life cannot be made. R&D costs should be expensed as incurred.

Section 19: Business Combinations and Goodwill – All business combinations should be accounted for using the acquisition method – merger accounting is not permitted. Goodwill is measured at cost less accumulated amortisation and accumulated impairment losses.

Goodwill is amortised over its useful life, or 10 years if a reliable estimate of its useful life cannot be made. Negative goodwill should be credited immediately to profit or loss.

Section 20: Leases – Leases are either finance or operating leases. A finance lease is recognised where substantially all the risks and rewards of ownership are passed to the lessee. A lease that is not a finance lease is classified as an operating lease.

Lessees should measure finance leases initially at the lower of the fair value of the leased property, or the present value of the minimum lease payments. Lessees should recognise operating lease payments on a straight line basis unless another systematic basis better reflects the user's benefit.

Section 21: Provisions and Contingencies – A provision is recognised where there is a present obligation as a result of a past event; it is probable that the entity will be required to transfer economic benefits in settlement; and the amount of the obligation can be estimated reliably.

Contingencies are not recognised, but subject to disclosure in certain circumstances.

Section 22: Liabilities and Equity - Equity is the residual interest in the assets of an entity after deducting all liabilities (present obligations of the entity arising from past events, the settlement of which are expected to result in outflows of economic benefits).

A compound financial instrument should be split into liability and equity components. The liability component is fair valued, with the residual value allocated to the equity component.

Section 23: Revenue – This equals the fair value of the consideration received or receivable in a sale transaction, or where assets yielding interest, royalties or dividends are used by others.

Section 24: Government Grants – These are measured at the fair value of the assets received or receivable.

Section 25: Borrowing Costs – These are all charged to profit or loss as incurred.

Section 26: Share-based Payment – Equity settled transactions are measured at the fair value of goods and services received, if this can be estimated reliably. For transactions with employees, or where the fair value of the goods and services cannot be measured reliably the transaction is measured by reference to the fair value of the equity instruments issued.

Cash settled transactions are measured at the fair value of the liability at the date of grant, with annual re-measurement of the liability until settlement date.

Section 27: Impairment of Assets – This section provides guidance on accounting for impairments of inventories, goodwill and non-financial assets, the general principle being that the carrying amount of an asset should be reduced to its recoverable amount when impaired.

Section 28: Employee Benefits – A liability should be recognised for the net of the present value of defined benefit pension plan obligations less the fair value of plan assets at each reporting date.

Section 29: Income Tax – Current tax liabilities and assets are recognised at the expected amounts payable/receivable using tax rates enacted at the reporting date.

Deferred tax liabilities and assets are recognised for tax payable or recoverable in future periods in respect of temporary differences, unused tax losses and unused tax credits.

Section 30: Foreign Currency Translation – Exchange differences are taken to profit or loss with the exception of differences arising on monetary items that form part of the net investment in foreign operations and differences arising from using a presentation currency other than the functional currency. These differences are taken to other comprehensive income.

Section 31: Hyperinflation – Where an entity operates in a hyperinflationary economy, the financial statements should be adjusted for the effects of the hyperinflation.

Section 32: Events after the End of the Reporting Period – An entity should adjust the amounts recognised in its financial statements to reflect "adjusting events" after the end of the reporting period.

Section 33: Related Party Disclosures – Ultimate controlling party and relationships between parent and subsidiaries must be disclosed. Key management personnel compensation must also be disclosed.

Section 34: Specialised Activities – This section provides guidance on how to account for agriculture, extractive industries and service concession arrangements.

Section 35: Transition to IFRS for SMEs – A number of exemptions are available to first time IFRS for SMEs adopters to make transition an easier exercise.