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Your ref:

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Dear Jeroen

CONSULTATION ON THE IFRS FOR SMEs

The ICAEW is pleased to respond to your request for comments on the European Commission paper, *Consultation on the International Financial Reporting Standard for Small and Medium-Sized Entities*.

Please do not hesitate to contact me or my colleague Pablo Portugal at the ICAEW Office in Brussels (pablo.portugal@icaew.com; 022303272), should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

CONSULTATION ON THE IFRS FOR SMEs

Memorandum of comment submitted in March 2010 by The Institute of Chartered Accountants in England and Wales in response to the European Commission consultation paper Consultation on the International Financial Reporting Standard for Small and Medium-Sized Entities, published in November 2009.

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INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the consultation paper *Consultation on the International Financial Reporting Standard for Small and Medium-Sized Entities*, published by the European Commission.

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.
4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the ICAEW, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms.
5. The ICAEW has been present in Brussels for over a decade, facilitating dialogue among stakeholders on key public policy issues and providing technical advice across a broad range of topics including financial reporting, audit, business law, ethics, corporate governance, financial services, tax, enterprise, skills and sustainability.
6. The ICAEW is listed in the European Commission's Register of Interest Representatives (identification number: 7719382720-34).

MAJOR POINTS

Support for the initiative

7. We welcome the Commission's initiative to seek stakeholders' views on the IFRS for SMEs in the light of the ongoing review of the Accounting Directives. We hope that this initiative inaugurates a comprehensive and forward-looking debate on the standard and the potential merits and challenges of its application in the EU. It is appropriate that the revision of the Directives takes into account this important international development, not least given the EU's record of global leadership in embracing international standards. The revision should be focused on the needs of unlisted companies (i.e. those that do not have securities traded on a regulated market) and the users of their financial statements, as well as the demands of the single market and globalisation.

Use of the IFRS for SMEs

8. We strongly support allowing Member States to introduce voluntarily the IFRS for SMEs in their jurisdiction. This is a high quality, comprehensive standard that is likely to be of benefit to many unlisted European companies, particularly those that have cross-

border dealings. Given that it is based on the principles of the IFRS framework, but is a simplified version of full IFRS, it is also likely to be a useful stepping stone for growing businesses considering a future listing.

9. Use of the standard in EU jurisdictions could be beneficial to the integration of the single market. As was the case with the adoption of full IFRS in 2005, we believe that the IFRS for SMEs could substantially increase comparability in the financial reporting of unlisted companies across countries, competitors and sectors. It could also facilitate trade and capital flows between the EU and other jurisdictions.
10. The standard could also serve to simplify the financial reporting environment within particular EU jurisdictions. In relation to the UK, one immediate advantage to preparers would be that, as well as being clearly-written, the standard is much shorter and more manageable than full UK GAAP. We anticipate that specific national advantages could be identified in other Member States.
11. We are of the view that the fundamental principles and conceptual approaches in international accounting as developed in the IFRS framework should be reflected in the regime for European unlisted companies in an appropriately simplified form - this new IFRS product provides this for non-publicly accountable businesses. In the long-term, it is in the interest of all stakeholders - including regulators, preparers and users of financial statements - that there is a basic commonality running through the regime for all categories of reporting entities, consistent with the evolution of financial reporting concepts and thinking internationally.

Interaction with the Accounting Directives

12. The Directives should not form an impediment for the application of the IFRS for SMEs in the EU. A number of Member States are likely to support the adoption - or permit the use - of this standard in their jurisdiction and this should be an appropriate route for Member States to comply with the Directives' requirements. Therefore it is important that the revised Directives do not include provisions that might be in conflict with the use of the then-current version of the IASB's standard as national GAAP.
13. We note the recent publication of EFRAG's draft advice on compatibility between the IFRS for SMEs and the Accounting Directives. We believe that this preliminary analysis has identified a small number of specific and isolated technical discrepancies and not a fundamental incompatibility in the overall principles and spirit of the Directives and the IFRS for SMEs. It should thus be possible, and indeed appropriate, to address these in the ongoing revision of the Directives, which are in any event overdue for review and updating. We will comment in due course on EFRAG's draft advice.
14. Given the apparent divergence of views across the EU on financial reporting by companies not within the scope of the IAS Regulation, including SMEs, we do not believe that increasing the rules-based content of the Directives would be the route to delivering simplification, nor to enhancing consistency and comparability across the EU. We believe strongly that the most effective simplification of the Directives would be achieved by enacting a set of principles-based requirements that serve the public interest and reflect the needs of users of unlisted company financial statements. The appropriate reporting regime for unlisted companies can vary considerably according to their individual characteristics and specific national environments. For this reason, we support the application of a 'bottom-up' approach in setting out a basic framework of fundamental accounting, reporting and publication principles that should apply across the single market, leaving detailed accounting practices to be addressed at the national and standard-setting levels. We are convinced that this approach would best serve the practical needs of SMEs and other unlisted companies as it would give Member States

flexibility to implement the common EU principles in the manner most appropriate to their national environment. The IFRS for SMEs would fit well into such a regime.

Cost/benefit considerations

15. Moving to any new financial reporting standard inevitably involves cost and effort. Introducing the IFRS for SMEs will require substantial project management on the part of national authorities and the relevant businesses, where they choose to adopt it. But these one-off challenges have to be measured against the long-term benefits of using a high quality, internationally-recognised standard. It is also worth noting that the standard features considerable built-in flexibility on cost/benefit issues.
16. Any analysis of the costs and benefits, at EU or Member State level, should reflect the additional costs incurred by accounting firms advising clients operating under different financial reporting regimes. The IFRS for SMEs would, for instance, facilitate education and familiarity with one common financial reporting language for the publicly listed and unlisted company sectors - this could deliver considerable cost efficiencies as regards, for example, the training of accountants. The costs involved will of course vary across the EU and we do not wish to anticipate the results of analysis in other jurisdictions. In the UK we expect the benefits to exceed the costs substantially in the long run, and that could well be the case in other Member States.

Role of national authorities

17. Whilst we support a move towards greater use of international standards as a strategic EU policy, in our view national authorities must remain active and retain responsibility for the maintenance and appropriateness of standards in their respective jurisdictions. Authorities may wish to retain their right to set national standards for unlisted companies, including adapting the IFRS for SMEs for use as national GAAP were it deemed necessary in the future to reflect the needs of users and preparers in their jurisdiction, although the objective should be to influence the IASB to ensure that future changes to the standard are appropriate for the EU environment.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1: Do you think the IFRS for SMEs is suitable for widespread use within Europe? Please comment, indicating whether there are any type(s) or size(s) of company that would benefit from adopting the standard.

18. In our view the IFRS for SMEs is a suitable standard for non-publicly accountable businesses. Businesses preparing financial statements for external stakeholders but without public accountability can benefit from use of this stand-alone standard aligned with international best practice. The standard is likely to be of particular interest to the many European companies that trade across borders or have cross-border investment partners. A further advantage is that some larger businesses will be aiming to join the junior or senior listed markets and applying the new standard would take them one step closer to full IFRS. From a user perspective, we understand that listed market analysts look at large private sector competitors in certain sectors, so introducing accounting requirements for such companies more closely aligned with IFRS would also be to their advantage.
19. The application of the IFRS for SMEs to small companies will need further consideration, particularly in the context of retaining existing exemptions and derogations from certain accounting requirements. Nevertheless, we consider that in the long-term the requirements for small companies should also be consistent with the broad principles of the IFRS framework and Member States should be able to use the

IFRS for SMEs as a basis for this approach, if there is sufficient flexibility within the law. These considerations should be taken up at Member State level.

Q2: 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? In particular, do you think increased international comparability of accounts prepared under the IFRS for SMEs will benefit your business?

20. We refer to our comments on costs and benefits in the Main Points section above and on comparability under question 4. Although the ICAEW as an organisation prepares accounts, we understand that this question is aimed at preparers not seen as representing the views of the accountancy profession. We believe that it may be necessary to collate cost/benefit data more systematically to obtain meaningful information.

Q3: 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?

21. This question is not applicable to the ICAEW.

Q4: Does increased international comparability of accounts prepared under the IFRS for SMEs benefit users?

22. Yes. We believe that user groups - including creditors, shareholders and investors - stand to benefit from the commonality brought by internationally-recognised financial reporting standards. There are clear advantages in achieving greater international consistency and comparability in financial statements given the increasingly interconnected nature of EU and global markets. The use of the IFRS for SMEs could very well advance the integration of European markets - as has been the case in relation to full IFRSs - by facilitating cross-border trade and investment in the unlisted sector. EU authorities and Member States should take into account this potential dimension in deciding on the use of the standard.

Q5: Do you think adoption of the IFRS for SMEs should be provided for within the EU accounting legal framework?

23. Yes, but not formally. We believe that the Directives should not form an impediment for the application of the standard in the EU. We refer to our response to question 6 below for our detailed view on this issue.

Q6: If yes, should such an option be limited to a Member State option (i.e. that each Member State would have the possibility but no obligation to accept IFRS for SMEs)?

24. We agree that the application of the standard should be optional to Member States. However, we are not in favour of referring to the SME standard in the Directives. A formal reference to the standard in EU law could, for example, demand a procedure for endorsing its future revisions, which we believe should be unnecessary.
25. We would welcome sight of further legal analysis from the Commission on these matters, to which we would be pleased to provide additional commentary. The key point, it should be emphasised, is that the Directives enable Member States to apply the IFRS for SMEs in their jurisdiction should they wish to do so.

Q7: Do you have other views on the possible adoption of the IFRS for SMEs within the EU accounting framework?

26. We have no further views on this matter.

Q8: Is there a case for giving companies, at EU level, an option to adopt the IFRS for SMEs?

27. As already noted, it is preferable for the adoption of the IFRS for SMEs to be considered at Member State level, as opposed to an EU-wide company option. The standard is likely to compare differently to individual national standards and SME accounting frameworks and in some countries the migration towards the IFRS for SMEs could involve a significant change in relation to current practices. Member States are therefore best placed to decide on the standard's application and scope. As noted in the Main Points section above, national authorities have an important role in addressing inconsistencies with the national legislation and designing an appropriate implementation timetable.

Q9: What should be done, in your view, where there is incompatibility between the Directives and the IFRS for SMEs?

28. Discrepancies between each should be addressed in the revision of the Accounting Directives. This would reflect our view that the modernisation of the Directives should seek to align their requirements - in an appropriately simplified form - to the latest financial reporting developments and international thinking, embodied in this IFRS standard. The technical incompatibilities identified in EFRAG's preliminary analysis (published on 1 March 2010) relate to specific accounting treatments in isolated areas rather than fundamental principles - as such they should be solvable in the Directives' revision process. If the Commission took no action in relation to the Directives, there would be nothing to stop any Member State using the IFRS for SMEs as its local GAAP, amended as necessary to be compliant with the Directives. It therefore seems sensible to find a way to make the law more compatible with the standard, written on a high-level, principled basis to minimise the need to amend the Directives as the standard evolves over time.

Q10: In the light of the publication of the IFRS for SMEs, do you see a need for 'rules-based' Accounting Directives in the future? Other than the five items listed in paragraph 4.3 above [see consultation document], what aspects of financial reporting should the revised Directives address, and in what level of detail?

29. The revised Directives should comprise a basic framework of fundamental accounting, reporting and publication principles to be applied across the single market. We are convinced that this approach would best serve the objectives of the simplification programme and the practical needs of unlisted companies as it would give Member States flexibility to implement the common EU principles in the manner most appropriate to their national environment. Past experience in the accounting sphere strongly suggests that embedding prescriptive rules in legislation stifles development of best practice and hinders the ability of financial reporting to keep pace with market developments. Detailed accounting practices beyond the essential requirements enshrined in legislation can be best addressed at the standard-setting level, where new and revised guidance can be developed promptly as the need arises. The apparent divergence of views across the EU on the detailed unlisted company requirements and the IFRS for SMEs would also make it difficult to maintain the rules-based content of the Directives in a way that suits each Member State situation.
30. We agree with the approach noted in the consultation document for a concise Fourth Directive based on the five principles proposed by the Commission. However, we would need to consider the extent of the drafting of any detail into the revised Directive. In particular, it would be better to keep basic layouts to a minimum, and maintain sufficient flexibility as to which statements must be included.

Q11: Are there any elements of the IFRS for SMEs that should be incorporated within the revised Directives?

31. Only to the extent that it meets the principles outlined. We think that it is unnecessary to include most of what is in the IFRS for SMEs on specific items. Even in terms of the more general chapters in the standard (Sections 1-8 and Section 10), where some requirements might be appropriate for inclusion in the Directives, changes are expected from the development of the IASB conceptual framework and the Financial Statement Presentation project.

Q12: Do you have any other observations or comments on the IFRS for SMEs or the project to overhaul the Accounting Directives?

32. We have no further comments.

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