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Re: IASB Questionnaire on Possible Recognition and Measurement Modifications for Small and Medium-sized Entities (SMEs)

Dear Paul,

As member of the Working Group, I am pleased to comment on the Questionnaire issued on the accounting for SMEs. The answer given are based on the work which the CNC has carried up to this point. The CNC work is not completed and thus the answer given below might change.

**Regarding the scope of the project**

I am concerned that the IASB has concluded the SMEs project will apply to non public accountability entities (NPAEs), as, in our mind the concept is very imprecise and will lead to various interpretations. This is all the truer since the range of SMEs is potentially very wide, on the one side large non listed entities, and on the other small entities the financial statements of which only interest the manager/owner.

I would therefore favour a classification that would be easy to implement, even though perhaps less conceptually consistent :

- Listed entities and the larger non listed, as defined by the importance of their revenue, should use full IFRS.
- Micro-companies, described as very small entities should not use SME standards.
- Entities that are not included in the two first categories should use SME standards.

**Information and Presentation of financial statements**

I understand the second phase of the SME project would tackle presentation and disclosure issues. Nevertheless, I would emphasize two important points:

1- Presentation of financial statements.

Users such as national statistic bodies or central banks and preparers of financial statements of SMEs express a strong need for standardised format.

2- Disclosures

A significant reduction of information is required by Standards regarding users needs of SME financial statements.

### **Materiality**

The concept of materiality is important although not easily grasped and rarely used by preparers of SME financial statements. They are accustomed to predefine limits to decide what they should do rather than use judgments to appreciate materiality. Consequently it appears necessary to elaborate guidelines about the way to apply this concept in order to help preparers. (See below IAS 17, discounting)

You will find enclosed my detailed comments on the Questionnaire. If you have any comments, don't hesitate to contact me.

Yours sincerely,

**Fabienne RENAUD-AÏDAN**  
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**On Standards for SMEs**

# **IASB Questionnaire on Possible Recognition and Measurement Modifications for Small and Medium-sized Entities (SMEs)**

## **COMMENTS**

**Question 1: What are the areas for possible simplification of recognition and measurement principles for SMEs? In responding, please indicate:**

- **the specific accounting recognition or measurement problem for an SME under IFRSs;**
- **the specific transactions or events that create the recognition or measurement problem for an SME under IFRSs;**
- **why is it a problem; and**
- **how that problem might be solved.**

The suggested simplifications are organised into the following themes:

- 1- Fair value
- 2- Discounting
- 3- Simplifications based on cost-benefits arguments
- 4- Simplifications because transactions are unlikely to occur in an SME context or complexity of the transactions require application of the full IFRS standard
- 5- No simplification on recognition and measurement identified

### 1- Fair value

I agree with EFRAG comments on the definition of “easily disposable assets”, and consider that fair value measures should be permitted or required only if both the following criteria are met:

- 1) Observable market data are available.
- 2) 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 program to locate a buyer and complete the plan have been initiated.

### **IAS 39 Financial instruments**

Hedging instruments and hedged items are discussed below. For other financial assets, I consider that only two categories of assets are useful:

- Easily disposable financial assets. Such assets, quoted shares, bonds or derivatives should be required to be measured at fair value. In the case shares or bond are not quoted, such assets should be required to be measured at amortised cost.

- Non available for sale or non-easily disposable assets. Such assets should be required to be measured at amortised cost.

The category held-to-maturity investments does not appear to be useful for SMEs. The effective interest method should be used to calculate the amortised cost, unless its effect are immaterial in which case the linear method should be used. Consequences of reclassifications should be rewritten in order to provide the same kind of impact as in full standard.

### **IAS 16 Property, plant and equipment**

I consider the relevant value of these assets for SMEs is the cost model. In SMEs, there is a presumption that property, plant and equipment cannot be sold on the market at any time without causing any disruption or major change in the entity's operations. Therefore the criteria of easily disposable cannot be used. Moreover, to assess that an asset is easily disposable would increase preparers' and auditors' work and could lead to very long discussions.

I consider the option for the revaluation model should be deleted in SMEs standard.

### **IAS 38 Intangible assets**

I consider the relevant value of these assets for SMEs is the cost model. In SMEs, there is a presumption that intangible assets cannot be sold on the market at any time without causing any disruption or major change in the entity's operations. Therefore the criteria of easily disposable cannot be used. Moreover, to assess that an asset is easily disposable would increase preparers' and auditors' work and could lead to very long discussions.

I consider the option for revaluation model should be deleted in SMEs standard.

### **IAS 40 Investment property**

I believe that measuring investment property at fair value when the assets are not easily disposable (as defined above) provides users of SMEs financial statements with information that is not relevant to their needs. Therefore I suggest as EFRAG's proposal restricting the revaluation option so that it can only be applied to easily disposable investment property.

If SMEs measure property investment at cost, I suggest not requiring providing disclosures about fair value.

### **IAS 41 Agriculture**

Under IAS 41 biological assets shall at initial recognition and at each balance sheet date be measured at fair value less estimated point of sale costs. I believe biological assets will meet the definition of easily disposable assets and therefore fulfil the overall criteria for applying fair value. Only if the overall principles for applying fair value are not met cost should be applied.

## **IAS 27 Consolidated and separate financial statements**

### **IAS 28 Investments in associate**

Under IAS 27 investments in subsidiaries shall be measured in separate financial statements at either cost or fair value in accordance with IAS 39, even if those investments are not easily disposable. IAS 28 contains similar provisions for investment in associates.

I consider there is a presumption for SMEs that investment in subsidiaries or in associates cannot be sold on the market at any time without causing any disruption or major change in the entity's operations. Therefore the criteria of easily disposable cannot be used. Moreover, to assess that a subsidiary or an investment in associates is easily disposable would increase preparers and auditor works and could lead to very long discussion.

I consider the option for revaluation model should be deleted in SMEs standard.

## **IFRS 5 Non-current assets held for sale and discontinued operations**

If the general principle about easily disposable assets outlined above is incorporated into the SMEs standards, there no need to include the measurement provisions of IFRS 5 in the SMEs standards.

However two IFRS 5 provisions need to be retained and can be incorporated in other standards:

- the definition and related requirements of a group of assets held for disposal (and associates liabilities) should be included within the standard on non-current assets;
- the definition and presentation of discontinued operations could be included within the standard on the presentation of financial statements.

## 2- Discounting

I believe that discounting principle should be use in SMEs when discounting effect is material. Regarding this aspect see the covering letter asking for guidelines on materiality for SMEs.

I consider that only medium term and long term commitments should be discounted, and decommissionning obligations and employee benefits should be mandatorily discounted.

In IAS 16, IAS 38 and IAS 18, if payments are deferred beyond the normal credit term the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is recognised in the carrying amount of the item in accordance with the allowed alternative treatment in IAS 23. I consider that if payments are deferred beyond the normal credit term but less than one year SMEs are not required to recognise the difference as interest.

## **IAS 39 Financial instruments**

Non interest bearing security deposit:

If non interest bearing is a common market practice on that kind of financial assets, I suggest the discounting of these assets should not be required.

### 3- Simplifications based on cost-benefits arguments

## **IAS 38 Intangible assets**

- Internally generated intangible assets

I agree with EFRAG proposal to introduce option to expense internally generated assets immediately in profit or loss.

I agree with the reasons exposed in EFRAG comments to suggest this simplification, users do not need internally generated intangible assets to be capitalised in order to assess the entity's ability to pay its liabilities in the short and medium term.

Furthermore I consider it eases the burden for preparers who would no longer have to demonstrate that the relevant recognition criteria have been met.

- Amortisation and/or depreciation

I do not agree with the EFRAG's proposal that a distinction between intangible assets with an indefinite life and those with definite life should not be made in the SMEs standards and that all assets including goodwill should be treated as assets with a finite life and amortised.

There are different intangible assets as taxi or bar license, brands that have indefinite life, and I do not believe these kind of intangible assets should be amortised.

Therefore I consider intangible should be classified in two categories:

- Intangible assets with an indefinite life should be impaired, annual impairment test.
- Intangible assets with definite life should be amortised on the life of the assets, and impairment test if there is indication of impairment.

## **IFRS 3 Business combinations**

- Identifiable assets and liabilities acquired in a business combination

I consider that the principle of allocating at the acquisition date the cost of the business combination to the assets and contingent liabilities that satisfy the recognition criteria at their fair value should be maintained. I disagree with EFRAG's proposal on that particular point.

I suggest maintaining the carrying values for the assets acquired (pooling method) in cases and under conditions that need to be defined.

- Impairment of goodwill

I agree with EFRAG's comments about the complexity and the weight of impairment test of goodwill for the SMEs and I consider that a systematic annual impairment test

of goodwill is not necessary for SMEs. The users are mainly interested in the ability to repay the debt in the short term and also in the operating profit because it is part of the cash flow. Because the present value of the entity is less important than cash flow I believe SMEs amortisation of goodwill should be reintroduced and an impairment test should be required only if there is indication of impairment as prescribed in IAS 36. I also agree that SMEs standards should stipulate a maximum amortisation period of 20 years.

However I believe impairment test should be maintained as an option for SMEs that would adopt full IFRS in the future.

### **IFRS 5 Non-current assets held for sale and discontinued operations**

See my answer in IAS 1.

### **IAS 36 Impairment of assets**

As mentioned in my comments on IFRS 3 and IAS 38 I suggest reintroducing amortisation of goodwill for SMEs and that impairment test should be required only if there is indication of impairment as prescribed in IAS 38.

In my view the costs of a very comprehensive impairment test to be prepared if indication of impairment is not justified. SMEs will typically have restricted technical resources. I consider that the determination of recoverable amount should not be required for individual assets but should only be determined for the business as the whole notably when the entity is monoactivity. If the entity has several business the determination of recoverable amount should be determined for each business.

The way of identifying whether an asset may be impaired under IAS 36 should be retained for SMEs. If the carrying amount exceeds the recoverable value of the assets an impairment loss should be recognised.

### **IAS 39 Financial instruments**

I agree with EGRAG that it will ease the burden for SMEs if, in measuring financial assets and liabilities at amortised cost, they could use either the effective interest method or the straight-line method.

### **IAS 17 Leasing**

I consider the classification of leases under IAS 17 should remain in SMEs standard because it is of high importance for the users that all liabilities are reflected in the balance sheet to provide information to users of financial statements on the expected out flow of cash. However I believe there is a need to have more simple criteria to analyse contracts. As mentioned in the covering letter, I believe guidelines are necessary to help SMEs to appreciate materiality. In this idea I would suggest the elaboration of more readable illustrative examples.

Moreover I believe that a simplification could be made to the recognition criterion for financial leasing whereby the liability should always be measured at an amount equal

to the present value of the minimum lease payments. I believe this value is sufficient to fairly represent the value of the assets and the future liability.

### **IAS 40 Investment property**

I suggest that investment property held under a lease should always be measured at an amount equal to the present value of the minimum lease payments. I believe this value is sufficient to fairly represent the value of the assets and the future liability.

### **IAS 19 Employee benefits**

I consider the principle of recognising employee benefits should remain in SMEs standards.

However I suggest some simplifications in measurement of long-term employee benefits should be provided to enable the entity to make the calculation without outside help. I believe it would be very useful to provide simple illustrative examples for SMEs financial statements preparers. The split between service cost and interest costs does not appear to be useful for users of financial statements of SMEs. I suggest that this split should not be required.

### **IFRS 1 First-time adoption of International Financial Reporting Standards**

I consider the retrospective application very burdensome for SMEs and not providing useful information for users. I suggest proposing more prospective applications.

In this purpose I believe it would be useful to create an ad-hoc working group to elaborate simplifications for first time adoption of SMEs standards.

### 4- Simplifications because transaction are unlikely to occur in an SME context or complexity of the transactions require application of the full IFRS standard

### **IAS 39 Financial instruments**

#### **Hedging instrument**

I suggest to determine what are the most common hedging transaction for SMEs (foreign currency term sales or purchases...) and to provide specific accounting rules for these operations. In case an SME enters into more complex hedging transactions the entity should apply the principles under IAS 39.

### **IFRS 2 Share-based payment**

I believe that SMEs make share-based payments. However the fair value of equity instruments granted cannot in many cases be estimated reliably. IFRS 2 already addresses this in context of equity-settled transactions (paragraph 24) by permitting the equity to measure instead the equity instruments at their intrinsic value. I believe that same requirements should apply to SMEs. However the same option for measurement of the liability incurred in cash-settled share-based payments transactions does not exist under IFRS 2. I therefore suggest that SMEs should be allowed to apply intrinsic

value if the fair value of the liability cannot be estimated reliably when accounting for cash-settled share-based payment transactions.

**5- No simplification on recognition and measurement identified**

IAS 2 Inventories

IAS 8 Accounting policies, changes in accounting estimates and errors

IAS 10 Event after the balance sheet date

IAS 11 Construction contracts

IAS 12 Income taxes

IAS 18 Revenue

IAS 20 Government grants and disclosure

IAS 21 The effect of changes in foreign exchanges rates

IAS 23 Borrowing costs

IAS 29 Financial reporting in hyperinflationary economies

IAS 31 Interest in joint ventures

IAS 32 Financial instruments: disclosure and presentation

IAS 41 Agriculture

IASB asks the respondents to indicate if they believe that there is no specific accounting recognition or measurement problem for SMEs in relation to the areas for possible simplification listed in attachment A. Please find below my argument for why I believe that these principles should not be simplified for SMEs.

a. Measuring the cost of inventories under IAS 2.

Recognition and measurement principles in IAS 2 should be retained for SMEs because I believe that this is the way most management will manage their business to reflect its yearly activities. Therefore I believe that e.g. cost of conversion should be allocated as part of the cost of the inventory.

b. Use of the percentage of completion method for contracts under IAS 11 and for service revenue under IAS 18.

Recognition and measurement principles in IAS 11 and 18 should be retained for SMEs because I believe that this is the way most management will manage their business to reflect its yearly activities.

c. Deferred income tax accounting under IAS 12.

Recognition and measurement principles in IAS 12 should be retained for SMEs because there is a need for reconciliation of differences between the accounting base and the tax base; all liabilities should be recognised.

d. Measurement of defined benefit pension or other post-employment benefit liabilities under IAS 19.

Recognition and measurement principles in IAS 19 should be retained for SMEs to reflect the future obligation related to such defined benefit plans.

e. Consolidation of subsidiaries under IAS 27.

Application of IAS 27 should be retained for SMEs. Consolidated financial statements are needed to reflect the overall economic situation of the group. The consolidated cash flow is particularly important.

f. The equity method of accounting for investments in associates under IAS 28 and investments in joint ventures under IAS 31.

I believe that the equity value is the best available for investments in associates under IAS 28 and therefore should be retained for SMEs.

Very detailed information is needed for the consolidation purposes of joint ventures. This is why the option for applying the less burdensome equity method should be retained for SMEs as well as the option for consolidation.

g. Recognition and measurement of provisions and contingent liabilities under IAS 37.

Recognition and measurement principles in IAS 37 should be retained for SMEs to reflect all liabilities.

h. Derecognition and/or hedge accounting provisions of IAS 39.

I believe that the derecognition principles should be retained for SMEs as SMEs should not be allowed to recognise assets/liabilities that would not be recognised in a public listed entity.

## Question 2

**17. 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 IFRSs.**

IFRS 2	<p>SMEs generally do not enter into share-based payment transactions. The SME equivalent of IFRS 2 should simply refer back to IFRS 2.</p> <p><b>Response :</b></p> <p>I disagree. I refer to paragraph 3 in the response to question 1.</p>
IFRS 3	<p>SMEs seldom enter into business combinations. The SME equivalent of IFRS 3 should simply refer back to IFRS 3.</p> <p><b>Response :</b></p> <p>The present definition of SMEs cover a wide range of entities and we believe there is no reason to assume that SMEs seldom will enter into business combinations.</p>
IFRS 4	<p>Because companies that issue insurance contracts hold assets in a fiduciary capacity, they have public accountability. IASB standards for SMEs would not be intended for them. Therefore, an SME version of IFRS 4 is not needed.</p> <p><b>Response :</b></p> <p>I disagree because as mentioned in the covering letter only listed companies and larger non listed, as defined by the importance of their revenue should be formally excluded from the scope of SME standards</p>

IAS 11	<p>Combining and Segmenting Construction Contracts</p> <p><b>Response :</b></p> <p>I believe that the accounting principles for Combining and Segmenting Constructions Contracts should be retained for SMEs.</p>
IAS 12	<p>Temporary differences arising from investments in subsidiaries, branches, associates, and interests in joint ventures</p> <p><b>Response :</b></p> <p>I believe the accounting principles for Temporary differences arising from investments in subsidiaries, branches, associates and interests in joint ventures should be retained for SMEs; all liabilities should be reflected.</p>
IAS 16	<p>Revaluation model for property, plant, and equipment</p> <p><b>Response :</b></p> <p>I refer to paragraph 1 in our response to question 1.</p>
IAS 17	<p>Sale and leaseback transactions</p> <p><b>Response :</b></p> <p>I believe the accounting principles for sale and leaseback should be retained for SMEs.</p>
IAS 19	<p>Defined benefit employee benefit programmes</p> <p><b>Response :</b></p> <p>I believe the recognition and measurement principles in IAS 19 should be retained for SMEs to reflect the future obligation related to such defined benefit plan</p>
IAS 23	<p>Capitalisation model for borrowing costs</p> <p><b>Response :</b></p> <p>I disagree. We believe the existing recognition principles in IAS 23 shall remain.</p>

IAS 26	<p>Because retirement benefit plans hold assets in a fiduciary capacity, they have public accountability. IASB standards for SMEs would not be intended for them. Therefore, an SME version of IFRS 26 is not needed.</p> <p><b>Response :</b></p> <p>I agree.</p>
IAS 27	<p>SMEs generally do not have subsidiaries. The SME equivalent of IAS 27 should simply refer back to IAS 27.</p> <p><b>Response :</b></p> <p>I disagree on this and believe that principles should be part of the SMEs standards.</p>
IAS 30	<p>The entities to which IAS 30 apply are, by definition, entities with public accountability and, therefore, IFRSs apply to such entities.</p> <p><b>Response :</b></p> <p>IAS 30 is to be replaced by IFRS 7 and covers disclosures only so it is not relevant to this questionnaire.</p>
IAS 32	<p>Split accounting for compound financial instruments</p> <p><b>Response :</b></p> <p>I believe split accounting for compound financial instruments should remain for SMEs.</p>
IAS 36	<p>Because SMEs generally do not enter into business combinations, the material on impairment of goodwill in IAS 36 could be omitted from the SME standard on impairment of assets.</p> <p><b>Response :</b></p> <p>As mentioned above I believe that SMEs do enter into business combinations quite often.</p>

IAS 38	<p>Revaluation model for intangibles</p> <p><b>Response :</b></p> <p>I refer to paragraph 1 in response to question 1.</p>
IAS 39	<p>Derecognition</p> <p><b>Response :</b></p> <p>I believe derecognition criteria under IAS 39 should remain for SMEs. I refer to paragraph 4 in our response to question 1.</p>
IAS 39	<p>Hedge Accounting</p> <p><b>Response :</b></p> <p>I believe hedge accounting for SMEs should be much more simplified compared to the present requirements under IAS 39. I refer to paragraph 3 in response to question 1.</p>