

30 June 2005

**SME ACCOUNTING STANDARDS**

**Answers to questions submitted by the IASB  
on Staff Questionnaire on R&M modifications**

**III WORKING GROUP ON IFRS IMPACT AND CBSO DATABASES**

**European Committee of Central Balance Sheet Data Offices (ECCBSO)**

# CONTENTS

## I. INTRODUCTION

## II. GENERAL REMARKS

## III. ANSWER TO QUESTION 1 (areas for possible simplification of recognition and measurement principles for SMEs)

## IV. ANSWERS TO QUESTION 2 (topics to be omitted from SME standards)

### ANNEXES:

#### I. THE NEED FOR FOMATS IN SMEs

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## I INTRODUCTION

This document presents the opinion of the technical group of experts of the III WG of the ECCBSO on the questions submitted by the IASB in its discussion paper “Staff Questionnaire on Possible Recognition and Measurement (R&M) Modifications for Small and Medium-sized Entities”<sup>1</sup>. Please note that these opinions do not necessarily reflect the viewpoint of the central banks to which the members of the III WG belong.

The document is structured in three points besides this introduction and two annexes: point II presents some general ideas about standards for SME, in particular, on the crucial point of the threshold for defining an SME, on the mandatory fallback, the existence of alternative treatments, and relevance of fair value for SMEs, among others ; point III provides answers to question 1, on areas for simplification; point IV gives answers to question 2, on topics to be omitted: Finally, the annex I sets out the reasons why the existence of formats are necessary to compile data and create databases, not only for statistical aims, but also for other users needs.

The III WG does insist on the advantages of standard formats for companies (reducing the reporting burden), for the regulators in charge of handling and comparing data and for the standard setters (IASB, in this case) that assure the right use of the standards created.

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<sup>1</sup> The role of the III WG and the targets of the ECCBSO were explained in detail in the previous answer sent to IASB on 22<sup>nd</sup> September 2004. Those interested can obtain the information on the referred report or ask for further details to the members of the III WG.

## **II GENERAL REMARKS**

Before answering the questions submitted by IASB on R&M modifications for SME, the III WG deems necessary to provide some extra information on various aspects which are crucial, from our view point, for the correct use and reliability of SMEs standards.

### **1. SME definition**

A lot of respondents to the previous questions submitted by IASB in 2004, demanded a working definition of the SME. A working definition could include quantitative criteria, e.g. the figures currently used in the EU to separate small, medium and large corporations, and also criteria based on the activity developed by the companies; furthermore, we assume that within the scope of the SME project, banks, insurance companies and other financial intermediaries should be excluded as these companies are subject to special regulation and supervision schemes.

Therefore, the scope of the SME project should be, in our view, the following:

- companies with no shares or debts listed on an exchange market
- companies with less than 250 employees, less than 50m € turnover and less than 43m € total assets (recommendation of the EC on the definition on SME 2003/361/CE)
- no banks, no insurances, no other financial intermediaries, no investment funds or similar.

### **2. Mandatory fallback**

Although a part of the members of the III WG agree on the existence of a mandatory fallback to full IFRS, some doubts arise in others. Therefore, under this heading, main reasons for doubt on the convenience of this procedure are presented.

There is danger in establishing the mandatory fallback, that finally full IFRS would be introduced in thousands of small companies, depending on the level of detail of the SME standards. It all depends naturally on how the final SME standards will look like. If the SME rules are quite detailed, the mandatory fallback might be of small significance. In contrast

however, if the SME standards deal only with some topics and omit a number of others (e.g. like suggested by some members of the III WG in this comment letter the omission of consolidation procedures), full IFRS are indeed applicable for a lot of SMEs, and as a consequence they have to follow two sets of standards, which would contradict the objective of the EU to reduce the reporting burden on companies.

As a matter of fact, the nature and extent of the whole SME project of the IASB is still rather unclear at this moment, and therefore, the power of the mandatory fallback is also unsure. For those members of the III WG dissenting on the mandatory fallback, an option could be that if a special issue is not handled in an SME standard but in an IFRS, the SME should seek guidance in the respective IFRS for its accounting policy. It should not be obliged to use the full standard. Guidance from the framework is also possible. Additionally, a procedure similar to the one in IAS 8.10-12 could be chosen. Moreover, the dissenting members believe that the SME rules should be sufficiently comprehensive and that only should be excluded those recognition and measurement rules, which are absolutely inapplicable for the SMEs in mind (e.g. the rules in IFRS 4, IAS 26 and IAS 30).

### **3. Information and presentation of financial statements**

We wish the questions of presentation and information hadn't been set aside for future discussion, and we hope the consultation on these matters will be wide and open.

Indeed these questions are of primary importance for users as there is an interaction between the standards and the reporting formats. We believe that a process of standard setting that genuinely takes into account the user's needs has to cope with the questions of presentation and information at an early stage. In many cases the user's needs are naturally expressed under the form of reporting requirements, and the standard-setter will be able to get a valuable feedback from user's to the extent that he submit to them various options of reporting formats

We believe the need for formats is shared by most, if not all, users of SMEs financial statements. This is clearly the case for statisticians as illustrated in the annex I attached. This is also the case for credit lenders. The availability of detailed concepts that are

comparable among companies is a fundamental prerequisite for credit lenders to build a thorough and robust analysis of the creditworthiness of a company:

- insufficiently detailed format (let alone complete lack of format) may be misleading for the user who may form a different judgement on two companies which nevertheless have an identical financial profile;
- in any case, insufficiently detailed format will be time consuming for the user who will have to go fishing for the information and, at the end, it will be costly while making ineffective an automated solution as a first step in the analysis process.

#### **4. Alternative treatments**

We wish that the principles for SMEs do not give rise to a multiplication of alternatives in order to conciliate a simplified treatment and a more complicate one that could be presented as an objective to tend to, except if the two treatments are very similar in their effects. As users of financial statements, we are generally opposed to accounting alternatives which reduce comparability and may give rise to opportunist approaches.

#### **5. Need for guidance and for a reassessment of the materiality principle applicable to SMEs**

Guidance is of the utmost importance for both, preparers and users of SMEs financial statements. In many instances, we think that a simple illustration of the accounting treatment would be of great help. Likewise, a clear understanding of the notion of materiality seems essential as it could reduce significantly the burden of SMEs which enters into specific operation that may not be material with respects to their other operations.

#### **6. Relevance of the fair value for SMEs**

Many would agree on the fact that if it is not always easy to obtain a reliable fair value measurement of an asset or a liability in the frame of a listed company, it is all the more so in SMEs.

The question is: should the fair value measurement for SMEs be completely dropped or should it be restricted to some predetermined assets and liabilities? Members of the WG

fully agree on the second option, that is to say, limit the use of fair value for several specific assets.

Some members of III WG have a good knowledge on risk assessment and the kind of information that is necessary for the analysis of the creditworthiness. From their experience it can be assured that fair value only should be employed by SMEs only in certain cases, in a way more restricted than in full IFRS. In fact, the use of fair value by SMEs could even affect the access of these companies to banking financing. Annex II provides more detailed information on this matter. Some would consider being even more systematic.

An important preoccupation of credit lenders is to distinguish between what is acquired and what is only potential. As a matter of fact, the repayment of the debt by the company will depend on its effective cash in-flows and not on the increasing estimated value of its operational assets.

Following a conservative approach, i.e. disregarding capital gains until they have been converted into cash, makes fair value measurement inappropriate in any case.

Following a less conservative approach, makes possible the use of fair value measurement in the case the value of the asset can be reliably measured and the asset is easily disposable. Yet, we believe that:

- credit lenders are rather conservative; credit lenders lend more easily when they are confident that the accounts have been established according to a “conservative” approach. If not they will very likely adjust by restricting their decisions in a way that will not be optimal for the allocation of financial resources.
- capital gains are of little relevance for an assessment of the quality of the management because they have not been transformed into cash flow (yet) and they include forward-looking data such as interest rate assumptions. As far as assessing the management is concerned, the “past track record” of the management is essential, i.e. only cash flow and other “backward looking data” are relevant;

- in a SME few assets are easily disposable and can be reliably measured. In consequence, making developments on the fair value in the SME volume seems disproportionate with regard to the expected benefit.

In consequence, making developments on the fair value in the SME IFRS volume seems disproportionate with regard to the expected benefits. In other words, the use of fair value in the SME framework should be, at least, strictly limited to assets that are easily disposable and reliably measured.

### **7. Relevance of the discounting approach for SMEs**

In IAS 16, 38 and 18, if payments are deferred beyond the normal credit term (which happens in SMEs), the difference between the cash price equivalent and the total payment is recognised as interest over the period. The discounting approach may be quite complex for an SME to apply. Therefore, we believe that it should be used only when the effect is material, in particular for long term commitments and employee benefits.

Besides, when an operation bears no financial interest but is considered to be made at normal market conditions, we propose that the discounted approach should not be required (nor allowed).

### **III ANSWER TO QUESTION 1 (areas for possible simplification of recognition and measurement principles for SMEs)**

#### **1. IAS 12: Deferred income tax accounting**

In general, we believe that IAS 12 is one of the standards that belongs to the biggest challenges when a company changes to IFRS. It is commonly accepted that the standard poses high costs on a company. The reasons are quite numerous:

- The issue as well as the standard is quite complex.
- Staff needs a proper understanding of the issue and the rules. Consequently, a highly competent staff is necessary for this
- High training costs or, alternatively, high subcontracting costs
- High development costs in the IT systems, as each temporary difference must be accounted and the information must be collected
- High operating costs (staff), as each temporary difference must be accounted and the information must be collected

The III WG agrees on the previous paragraph, about the difficulties in the application of this standard. But there is no clear position on the relevance of the rules prescribed in IAS 12. For some members, a lot of rules in the standard might not be relevant for an SME:

- Some issues are not applicable, e.g. deferred taxes from consolidation, as SMEs usually do not have to set up consolidated accounts.
- From an analytical perspective of a user of an SME financial statement, deferred taxes often turn out to be irrelevant for his decision. E.g. deferred tax assets are often subtracted from equity as users do not consider those to be assets. Especially banks tend to do this, as a deferred tax asset is usually of no value in the case of insolvency. On the contrary, deferred tax liabilities are kept on the liabilities side, but they are often not fully understood.

For all these reasons, we believe that there should be an SME standard regarding income taxes that simplifies the accounting rules to a great extent.

As a minimum, we see the following simplifications in recognition and measurement to be necessary:

- The SME standard should reduce significantly the operating costs for SMEs in terms of deferred taxes, for instance by accounting deferred tax only when material.
- The recognition requirement of deferred tax assets for the carry forward of unused tax losses should be dropped. In practice, deferred tax assets from carry forwards are usually not considered as assets by a typical user of an SME financial statement, as it appears insufficiently secured (i.e. the company may not be in a position to use it at the end)
- The re-assessment of unrecognized deferred tax assets according to IAS 12.37 is too costly for an SME.
- The measurement rules in IAS 12.49-52B are usually either not applicable to an SME or not practical. Therefore, the measurement of deferred tax assets and liabilities shall be based on the enacted tax rate.

2. IAS 19: Measurement of defined benefit pension or other post-employment benefit liabilities

One of the objectives of IAS 19 is to prescribe recognition of all post-employment benefit obligations. Commitments of the defined benefit type are measured as the difference between the net present value of the benefit in x years' time and fair value of the plan assets. The yearly expense then equals the variation in these commitments between two accounting years.

First of all, we would like to insist on the importance of post-employment benefit obligations for SMEs. Due to the proportional increase of the ageing population, entities will be forced to provide in pension plans additionally to what can be legally obtained by means of the social security system. Indeed, more and more SMEs provide in such extra-legal pension schemes for their employees. Therefore, IAS 19 should not be included in list 2.

However, due to the corridor-approach and the way of accounting for actuarial gains and losses (amortisation-approach), measurement of defined benefit obligations can be quite

complex. For the calculation of the benefit's net present value, an SME can rely on an actuary. Taking into account the limited means of an SME, subsequent adjustments should be kept as simple as possible. Therefore, we suggest one area of simplification: reduction of actuarial gains and losses by limiting the volatility of the actuarial assumptions used in the calculation. Example: adjustments to the measurement of the obligations must only be made when the difference between the previously used discount rate and the current discount rate exceeds x % (nominal value).

Some members of the III WG envisage other possible simplification: the abolition of the corridor-approach and the immediate recognition of actuarial gains and losses in income statement. This option should be applied anyway with the previous one to avoid excessive volatility in financial statements of SME. The III WG declares there is no agreement on this point, so we cannot present a clear recommendation on the matter, except to make sure that any decided simplification will not lead to introduce additional volatility in the financial statements of SMEs.

3. IAS 27: Investments in subsidiaries, associates & joint ventures in the separate financial statements

Under IAS 27 these investments shall be measured in the separate financial statements at either cost or fair value in accordance with IAS 39. In accordance with our general view to limit the use of fair value for SMEs, we suggest to allow only measurement at cost.

4. IAS 32: Financial instruments - disclosures and presentation

For the least complex financial compound financial instruments, in particular for convertible bonds, which are not so infrequent in SMEs, we think it would be important to find out some measures of simplification. For what convertible bonds are concerned, a measure of simplification could be to recognize the total amount received in debt, without making any split.

As regard disclosures, and in anticipation of the following discussions, we think that SMEs do not have the in-house resources that large companies have to distinguish and disclose the very detailed information required by the standard. Moreover, the users of SMEs

financial statements generally need to perform a simple analysis of the data of each company but often require reproducing it over a large number of small companies, so the disclosure of qualitative information is less relevant than for publicly accountable entities. Therefore, we believe this standard is a good candidate for relevant simplifications / omissions. We would like to highlight among these the following:

- Interest Rate Risk (IAS 32.67-75): the required disclosures are much too detailed and descriptive.
- Credit Risk (IAS 32.76-85): the required disclosures are much too detailed and descriptive, only IAS 32.76.b should be required, and examples of what is considered a significant concentration of credit risk should be provided in the IFRS for SMEs.
- Valuation at fair value should not be allowed for SMEs. In IAS 32, this would have implications on the following paragraphs:
  - Fair value: IAS 32.86-93, IAS 32.94.e, IAS 32.94.f and IAS 32.94.g
  - Collateral: disclosures IAS 32.94.c.i and IAS 32.94.c.ii should not be required.

5. IAS 36: Impairment approach to goodwill and intangibles for indefinite life assets

IAS 36.10 requires that the recoverable amounts of the following types of intangible assets should be measured annually whether or not there is any indication that it may be impaired:

- an intangible asset with an indefinite useful life.
- an intangible asset not yet available for use.
- goodwill acquired in a business combination.

Furthermore IAS 38.88 indicated that the intangible assets are classified as:

- indefinite life: no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.
- finite life: a limited period of benefit to the entity.

An intangible asset with an indefinite useful life should not be amortised; its useful life should be reviewed each reporting period to determine whether events and circumstances

continue to support an indefinite useful life assessment for that asset. The asset should also be assessed for impairment in accordance with IAS 36.

We believe that the intangible assets with indefinite life are limited and the differences of the recoverable amounts accounted according finite or indefinite life are not significant. All assets, including goodwill, should be determined as assets with finite life and amortised.

6. IAS 36: Impairment of property, plant and equipment

IAS 36.66 requires that the recoverable amount of tangible assets (property, plant and equipment) should be determined for the individual asset, if possible. If it is not possible to determine the recoverable amount for the individual asset, then determine recoverable amount for the asset's cash-generating unit (CGU).

The CGU is the smallest identifiable group of assets:

- that generates cash inflows from continuing use, and
- that are largely independent of the cash inflows from other assets or groups of assets.

As the SME's tangible assets are limited and for cost benefit reason we suggest that the way of calculating the recoverable amount is simplified for SME's (at least no determination of CGU's should be needed).

7. IAS 38: Capitalisation of intangibles development costs incurred after commercial viability has been determined

In our opinion, current criteria set for the capitalisation of intangible development costs in IAS 38.57 are highly subjective and dependent of the will of the management. Our proposal is whether to define these criteria in a simple and objective way (for instance, without referring to cash-generating units from IAS 36) or not to allow any capitalisation of development costs.

8. IAS 39: Areas for possible simplification of recognition and measurement principles for SME's

- Use of the effective interest method
- Fair value measurement
- Accounting for foreign currency forward contracts
- Derecognising and/or hedge accounting provisions

Generally IAS 39 belongs to the most complex standards under IFRS and therefore necessarily needs to be simplified for the use of SMEs. Its complexity should not form part of the SME standards as it is expected that transactions include in IAS 39 will not likely happen in such entities.

Calculation of the effective interest rate requires, according to IAS 39, estimation of future cash-flows derived from the financial instrument, which could result in a complex and burdensome work for the SME. Consequently our proposal is to simplify the determination of the interest rate of financial instruments, for instance by limiting it to the cases where the effect is material.

Concerning the fair value measurement, one possibility could be to apply fair values only when a double threshold is met, i.e. if the market is liquid enough to provide observable data and the asset (or liability) can be sold on the market at any time, without causing any disruption or major change in the entity's operations. The other assets would be measured at amortized cost. Another possibility, more simple and may be not much different in most cases, could be to exclude totally fair value measurements.

Many SME perform their activity abroad, mainly through exportation of their products or services. An effective instrument to offset foreign currency risk is entering into foreign currency forward contracts, which shall be accounted for under IAS 39. However, the complexity of this standard might restrain use of foreign currency forward contracts, since a certain amount of resources will be needed to account for them. As these are the hedging instruments more likely to be found in SME, we consider some simplification on their accounting treatment would be highly advisable.

Finally, derecognising financial instruments could be too burdensome for SMEs if full IAS 39 is to be applied. We propose to summarize criteria of derecognition as well as transfers

as they might imply a cost to be considered when acquiring a financial instrument, due to difficulties arisen from the subsequent transfer or derecognition of the instrument from the financial statements.

9. IAS 39: Accounting for embedded derivatives

IAS 39 identifies the conditions under which an embedded derivative shall be separated from the host contract. Separate measurement of such embedded derivatives is often very complex. SMEs do not have the in-house resources that large companies have to deal with these complex issues. Moreover, we can state that embedded derivatives are not only used by a minority of SMEs. They are widely used by entities that are active in imports and exports in non-Euro currencies.

Therefore, we propose an SME version of IAS 39 which does not require separate measurement of embedded derivatives, not even in the case foreseen in the current version of IAS 39.

10. Fair valuation of property, plant and equipment (IAS 16), intangible assets (IAS 38) and biological assets (IAS 41)

We consider subsequent measurement of property, plant and equipment and intangible assets, biological assets at fair value is not convenient for SME as it may give rise to some difficulties when calculating fair values, as SMEs do not have many in-house resources at disposal when preparing financial statements. Besides, as the majority of SMEs are not audited, these valuations could be misused in order to hide the real situation of the entity, because figures shown in financial statements are unlikely to be checked.

In the case of intangible assets, the lack of a market for this kind of assets, together with their special characteristics which make comparison among them difficult, provides even more discretionally to their fair valuation.

Finally, concerning biological assets, we consider that most of them are going to be found in SMEs unable to spend large resources in the calculation of the fair value. Use of cost for biological assets will be much easier for SMEs. Nevertheless, when a active market exist

in the country of these assets, then fair value could be used for in its valuation, but only to the elements of biological assets for which the market exists.

11. IFRS 3: Business combinations

On this matter there is no full agreement within the III WG, because a majority believes that this standard should be simplified in line with EFRAG's opinion (19/05/2005), but other members tend to think that SME involved in a business combinations should apply full IFRS, as in their countries this kind of operations occurs rarely under control of a SME.

#### **IV ANSWERS TO QUESTION 2 (topics to be omitted from SME standards)**

In the hypothesis where the mandatory fallback would be deemed inappropriate for the SME accounting framework, it seems essential that SME standards cover a maximum of possible operations made by the typical SME. In other words, only rare operations made by SMEs should be omitted in the framework. We have identified the following standards as possible candidate for list 2:

1. *IFRS 2: Share based payments*

It can be expected that only those with proven high equity worth would be able to make settlements with their own equity instruments and these are likely to be considered large companies by national parameters. Therefore, these entities should have to apply the full IFRS to account for this type of transactions.

2. *IFRS 4: Insurance contracts*

IFRS 4 refers to accountancy of insurance contracts by the insurer. Due to the specific characteristics of an insurance contract, we consider extremely unlikely that an SME will work as an insurer. Besides, if an SME worked as an insurer, the entity should meet other legal and prudential requirements, enabling it, in our opinion, to meet principles in IFRS 4. Therefore, a simplification of IFRS 4 is not needed and it would be sufficient with a fallback to full IFRS 4.

3. *IAS 26 Accounting and reporting by retirement benefit plans*

All members of III WG agree that retirement benefit plans have public accountability, as they hold assets in a fiduciary capacity. IASB standards for SMEs would not be intended for them. Therefore, an SME version of IAS 26 is not needed.

4. *Investments in subsidiaries, associates and joint ventures in the consolidated financial statements (IAS 27, 28 and 31)*

Entities holding investments in subsidiaries, associates and joint ventures that can be considered to be material (for consolidation) would not be typical SMEs. They would approximate more the nature of a large enterprise. Therefore, such an entity should apply IAS 27, 28 and 31 as a whole (i.e. mandatory fallback) and no SME version of these standards would be needed. Nevertheless, there is no total agreement on this point within the III WG. Belgium, Spain and Portugal have informed that the number of SME that have to prepare consolidated statements are not significant. In other countries, like in France or Germany, the situation is not the same.

In the case of Belgium, over accounting year 2003, 261.668 SMEs deposited financial statements using an abbreviated questionnaire, which is allowed for SMEs. Average total assets of these 261.668 SMEs equal 590.615 €.

First of all, out of these 261.668 SMEs, only **13** have deposited consolidated financial statements, either over accounting year 2002, 2003 or 2004.

Secondly, out of these 261.668 SMEs, 11.350 (or **4,3%**) hold financial investments in other entities, for an amount over 250.000 € (we choose this limit in order to consider only materially relevant financial investments). Average total assets of these 11.350 SMEs equal 3.612.591 €<sup>2</sup>.

One can conclude that most of these 11.350 Belgian SMEs approximate large companies, as far as total assets are concerned. Therefore, in case they are legally obliged to establish consolidated financial statements, they should apply the current version of IAS 27, 28 and 31, so no SME version of these standards is needed.

On the reverse, in the case of France, the consolidated approach seems much less infrequent in SMEs. Over the 4.000 consolidated statements collected each year by the Banque de France, 35% have a consolidated turnover of less than 50 million € and 28% of

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<sup>2</sup> Taking into account that, in Belgium, a company is regarded as large if:

- the annual average of its workforce exceeds 100 persons or
- more than one of the following criteria are exceeded:
  - annual average of workforce: 50
  - annual turnover (excluding VAT): 6.250.000 €
  - balance sheet total: 3.125.000 €

less than 30 million €. As a consequence, it seems necessary to have a standard on consolidation for French SMEs. Similarly, in Germany SMEs have investments in subsidiaries, associates or joint ventures and simplification on consolidation procedures would be appropriate.

5. *Disclosures in the financial statements of banks and similar financial institutions (IAS 30)*

The objective of IAS 30 is to regulate and prescribe appropriate disclosure for banks and similar financial institutions, which supplement the requirements of other standards. The III WG believes that the role of the financial institution is very important and the top of the disclosures should be required for them. As confirmed by the definition of public accountability, financial institutions should not be regarded as SMEs. Therefore, we believe that a light version of the IAS 30 for SMEs is not needed

## **ANNEX I: THE NEED FOR FOMATS IN SMEs**

In countries typically classified under a Continental European accounting tradition (among which Germany, France, Italy, Spain, Belgium, and Portugal, but many others), the vast majority of concepts required by several of the users of the accounting information are extracted directly from the national GAAPs, specifically they are detailed items of compulsory disclosure from the models of tables that companies must published in their financial statements. In fact, under the Continental European accounting tradition, GAAPs provide “models of balance sheet and income statement (which) contain detailed elements [...] and companies must disclose in the notes any other material information (which) may be interesting”, Ding et al. (2001).

The availability of detailed concepts that are comparable among different companies is a fundamental prerequisite to allow the production of high quality statistics from accounting information in any country. More importantly, it is a fundamental prerequisite to allow compilation of any database with detailed information that is comparable among a wide variety of companies. These databases can serve as a valuable tool to support the decisions of a variety of users, including management teams when finding ways to improve their performance, as suggested by Price Waterhouse Coopers (2004), and investors when choosing their investment portfolio. In fact, investors' use of fundamental analysis to evaluate the worth of securities is typically restricted to a small number of cases because it is very costly and time consuming. The possibility of analysing large amounts of detailed financial statement information simultaneously and at small costs would open new avenues for research into fundamental analysis and its relationship with risk diversification.

Nonetheless, under Continental European traditions the need for highly comparable accounting information reaches even farther, especially in what SMEs are concerned. It must be stated that non-publicly accountable companies are the vast majority of companies in these countries. Franks and Mayer (1994) point out that while Anglo-Saxon countries have a large number of listed companies, in the Continental European countries only a small proportion of the total number of firms is listed. Ooghe and Vuyst (2001) say firm ownership tends to be much more concentrated in Europe than in North America. Allen and Gale (2000) also characterise Continental European and Japanese financial

systems as being “bank-based”, while the U.S. system is more “market-based”. Some studies carried out by the European Committee of Central Balance Sheet Data Offices also seems to support this idea (1997; 2001). In these environments, the problem of management discretion and agency issues is much less worrying than in a market-based system. The tendency that countries under a Continental European accounting tradition have a bank-based financial system, i.e. company normally asks for funds to banking institutions, and, therefore, commercial banks ask for annual accounts and information necessary to assess the risk of the operations. The next chart provides the percentage of companies existing in the country (or in the database of the CBSO, when national data is not available), that ask commercial banks for finance:

Percentage of companies financed by commercial banks<sup>3</sup>

2003 figures	Germany	France	Italy	Spain	Belgium <sup>4</sup>	Portugal
Large companies	70-80%	57-59%		81%	48 %	n.a
SME's	80-90%	46-64%		73%	62 %	63%

Therefore, unlike the disseminated owners of publicly accountable entities, who need to have a very deep knowledge of one company at a time, the users of SMEs financial statements generally need to perform a simple analysis of the data of each company but often require reproducing it over a large number of (small) companies, so the disclosure of qualitative information is less relevant than for publicly accountable entities.

<sup>3</sup> Information provided by CBSO of Germany, Belgium, Portugal and Spain, obtained from the total population or/and a sample of companies; information provided by National Institute of Statistics of France.

<sup>4</sup> Under the Belgian Code of Companies, a company is regarded as large if:

- the annual average of its workforce exceeds 100 persons or
- more than one of the following criteria are exceeded:
  - annual average of workforce: 50
  - annual turnover (excluding VAT): 6 250 000 €
  - balance sheet total: 3 125 000 €

The *full questionnaire* must be used by large companies.

The *abbreviated questionnaire* may be used by small companies.

Out of 18.143 full questionnaires over accounting year 2003 received, 8.706 (or 48%) have bank loans, either with a maturity of over one year or with a maturity of less than one year.

Out of 261.668 abbreviated questionnaires over accounting year 2003 received, 162.890 (or 62%) have bank loans, either with a maturity of over one year or with a maturity of less than one year. This percentage also includes small companies having finance lease borrowings with a maturity of over one year, because the abbreviated questionnaire does not allow separating them from the bank loans over more than one year.

However, under GAAPs typically identified as Anglo-Saxon, “firms tend to publish relatively simplified balance sheet and income statements and provide afterwards detailed indexed notes”, Ding et al. (2001). In such financial statements, comparable accounting detail among different companies is often unavailable. This particular aspect has the following consequences:

- a comparison of the data published in the financial statements of different companies in one same country must be made at a much less detailed level of conceptual depth; the detail is similar to what is possible when comparing companies from different countries using different GAAPs. Examples of this are two web sites, Edgar Online’s “XBRL Express Dashboard” and Price Waterhouse Cooper’s “EdgarScan”, which provide a comparison of the data reported by different American companies to the Securities Exchange Commission: most variables for which a comparison is possible are rather aggregate; less aggregated variables are only provided by a few companies; the level of detail provided by all companies is similar to that of the “BACH” international database. Do notice XBRL Express gathers information published using XBRL, which serves to demonstrate how XBRL alone will not solve this issue.
- when detailed data is collected, for example through the use of questionnaires, concepts are especially tailored and the observed entities’ information is adjusted through potentially complicated calculations to fit the questionnaire concepts; as an example, consider question 3 of the Quarterly survey of financial statements conducted by Statistics Canada (2002), which asks for the total amount of Inventories but clarifies “Exclude inventory of leased assets of operating lessor - see item 9(a) and capital leased”. Typically under the Continental European accounting tradition, this clarification would be a part of the GAAP itself and all users would be aware of it. Price Waterhouse Cooper’s AMMBIT database is only fed by data collected by accredited auditors. As such, collection of detailed accounting data under Anglo-Saxon accounting traditions is likely to be more time consuming, costly and error prone.
- given these problems in collecting accounting data, “Anglo-Saxon statisticians” often have to recur to compiling smaller samples and/or use physical rather than accounting data collected from companies; an obvious consequence of using smaller samples in Statistics is that any estimates are more permeable to sampling

error. As Greenspan A. (2001) put it about business economics, “greater payoffs will come from more data than more technique (to analyse existing data)”.

- finally, the possibility each company has not to divulge items that are not material for the understanding of its own financial situation (e.g., IAS1§29-31) has as consequence that the non-disclosure of an item by a company does not mean it equals zero (as it would under Continental European traditions). The magnitude of the difference to zero will not be the same for different companies, as materiality is assessed in relative terms. For Statistics, the addition of all of these non-zero items for all companies in a country is certainly a material amount and creates a new source of error that adds to for instance the already existing sampling error. This is more serious if companies not only do not divulge, but also are not able to isolate economically/statistically relevant items in their information systems.

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## Document Management

**Document name** **SME ACCOUNTING STANDARDS. Answers to questions submitted by the IASB**

This document presents the answers agreed by the members of the III WG to the questions submitted by the IASB in its discussion paper on possible recognition and measurement modifications for SMEs. In some cases there has been no total agreement, what is showed in the document

**Release** WGIII\_SMEprojectCommonviews\_2005F  
Date:30/06/2005

**Revision History** Each distributed document forms a "final version".  
List of successive "final versions"

Revision version	Revision date	Summary of Changes
WGIII_SMEprojectCommonviews_2005D1	17/06/2005	First document for comments, containing contributions by members of the WG
WGIII_SMEprojectCommonviews_2005D2	24/06/2005	Document including all comments received from members of the WG, homogenised and filtered to develop a draft of common answer
WGIII_SMEprojectCommonviews_2005D3	29/06/2005	Third draft of the document, proposed as final version once approved.
WGIII_SMEprojectCommonviews_2005F	30/06/2005	Final version of the document, with minor amendments in the format.

**Distribution** This document has been distributed to:

Version	Date of issue	Name
WGIII_SMEprojectCommonviews_2005D1	17/06/2005	Members of the III WG
WGIII_SMEprojectCommonviews_2005D2	24/06/2005	Members of the III WG
WGIII_SMEprojectCommonviews_2005D3	29/06/2005	Members of the III WG
WGIII_SMEprojectCommonviews_2005F	30/06/2005	IASB (Paul Pacter) / EFRAG (Charlotte Norre) / ECCBSO (Franco Varetto) / Members of the III WG

### Version management

Key dates: For each final version of the document, key dates for the national revisions or corrections. Name and date of revised document sent by each member

Members	Draft		Revision		Approval
	Name	Date	Name	Date	Date
Austria	Sabine Wukovits	02/06/2005			30/06/2005
Belgium	Camille Dümm Saskia Vennix	03/06/2005	Camille Dümm Saskia Vennix	23/06/2005	30/06/2005
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