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Re: ED IFRS for SMEs

Dear Sirs,

We are pleased to respond to your request for comments on the **ED IFRS for SMEs**.

The OIC supports the initiative of the IASB to draw up a specific IFRS for SMEs. This is clearly an important measure given the wide range of entities concerned. Through this principle, it should be possible to take a significant step forward towards achieving real convergence at global level in terms of accounting rules that also apply to SMEs. It would facilitate international comparability of the financial statements of SMEs, with consequent lower costs of capital and a more efficient allocation of such capital at international level. The homogeneity of such financial statements and the transparency of the information provided would also foster improved management of SMEs as the management would be able to compare its performance with the experiences and results of similar entities in other countries. There would also be a better understanding and control of operations undertaken not only by the management but also by stakeholders.

Concerning the current version of the Exposure Draft (ED), the OIC welcomes the simplifications made to the document by the IASB compared with the earlier preliminary view (PV). However, we feel that these simplifications are not yet sufficient given the entities concerned and the typology of the stakeholders interested in the financial statements of SMEs.

In our opinion, the document requires further work both in terms of its structure and specific points. First, if the aim is to establish simpler rules for entities that do not apply the full IFRSs, references to the full IFRSs must be avoided, as otherwise, the preparer of the financial statement will have to know not only the IFRS for SMEs but also the full IFRSs. In this way, it will avoid a situation where changes to the other IFRSs automatically have knock-on effects on the principle for SMEs. Therefore, what is needed is a “stand alone” document.

Second, the field of application of the principle requires greater clarification. The information needs of the stakeholders of an entity with 50 employees (given as the reference target in the document) cannot be considered the same as those of a far larger entity merely because we are dealing with non-publicly accountable entities. In these cases, the stakeholders and their needs are different and, therefore, in general, cannot be lumped together in a single document. The simplifications in the accounting principles should be calibrated to reflect the real information needs of the stakeholders of such entities, bearing in mind their organizational structure. In particular, in the ED, the recognition and measurement criteria envisaged, as well as the related information required, seem excessive for an entity with 50 employees, as assumed in the document. Further simplifications seem necessary. For example, the extensive use of fair value for entities with just 50 employees does not appear to be in line with the Board’s aim of providing simplified rules for SMEs. Indeed,

as EFRAG suggests, the use of fair value should be limited to a smaller number of items and only where there is an active market and the entity intend to dispose or transfer the asset. This would lessen the complexity of the criteria applied, so reducing the risk of errors or abuse, which more readily occur where the rules are more complex and where greater discretion is given to the preparers of financial statements.

Given the aim of the project and the entities that it concerns, there should be options that allow entities to choose the accounting principle that best suits their particular reality. The introduction of rigid principles to be applied at all times and in all cases would work against the entity and its users need, and would clash with the logic underlying the full IFRS. It seems difficult to imagine providing fewer options compared with the full IFRSs for entities less equipped in terms of organization and with stakeholders with lower information needs, as is the case with SMEs. It seems appropriate to retain some options concerning the measurement of items of the financial statements, especially non-financial assets.

If it is necessary to modify the document because one agrees with the idea that it should be a stand alone document, with its own simplified principles, then it also seems necessary to re-think its structure, with a re-organization of the document in such a way as to ensure its consistency and avoid repetitions or mixing together of different parts and of principles and application guidance. In this regard, we support EFRAG's proposed modification of the structure.

Question 1 – Stand alone document

With the objective of a stand alone document in mind, are there additional transactions, other events or conditions that should be covered in the proposed standard to make it more self-contained? Conversely, is there guidance in the draft standard that should be removed because it is unlikely to be relevant to typical SMEs with about 50 employees?

The OIC agrees with EFRAG's position on this. Indeed, the OIC believes that the existing cross-references and the fall back to the full IFRS should be eliminated. Only a stand alone document will allow the preparers and users of the financial statements to avoid having to consult both sets of principles (the full ones and those for SMEs). It is our opinion that only a principle that is self-contained, concise and simple can meet the goals of being easy to understand, easy to apply and useful for decision-making by SME stakeholders, which is what the IFRS principle should strive to achieve.

Question 2 – Recognition and measurement simplifications that the Board adopted

Are there other recognition and measurement simplifications that the Board should consider? In responding, please indicate:

- (a) the specific transactions, other events or conditions that create a specific recognition or measurement problem for SMEs under IFRSs;***
- (b) why it is a problem;***
- (c) how that problem might be solved.***

The OIC agrees with EFRAG on the need for further simplification of the recognition and measurement principles set out in the ED.

One area of financial statements where further simplification is desirable is that of financial instruments. The complexity of this area does not stem so much from the existence of four categories (as the BCs of the principle seem to assert) from the application of fair value also in cases where there is no active market. We are against indicating fair value as the default criterion for general application, except where the entity opts for amortized cost in the event of the conditions as per para. 11.9 of section 11. With respect to entities applying IAS 39, it would appear that fair value would be applied in more extensive terms to those that are less well equipped in terms of organization and that have stakeholders whose information needs are generally less sophisticated.

Therefore, a simplification of the measurement principles would be appropriate. We would agree with EFRAG's suggestion of having two categories. The first relates to the financial instruments easily negotiable, for which prices are observable on the market and therefore generally referable to financial instruments held for trading, to which fair value should apply, while the second would include all other financial instruments, which should be measured at amortized cost. We suggest always applying fair value measurement for derivative instruments, also considering that often there may be no initial cost. The delicate nature of the issue and the risk inherent in such contracts suggest that the fair value criterion should always be adopted already at the financial-statement measurement stage. A special disclosure would not in itself be sufficient to evidence immediately the variations in value of the results of the financial statements connected to it.

For reasons of simplicity, in calculating the amortized cost, one could consider adopting the straight-line method rather than the effective interest method.

We do not agree with the point in the EFRAG proposal that says that no mention of transaction costs is made. The reference made to point 11.8 and 11.A.2 of the section already seems to indicate the treatment for such costs. In any event, if the IASB re-formulates the principle, it will be necessary to deal with and re-consider the form of reference for such costs.

Question to EFRAG constituents:

Do you prefer view 1 (embedded derivatives are not recognized) or view 2 (they are recognized via split accounting)? Do you wish to gather some input and raise a question to our constituents?

As far as embedded derivatives are concerned, the OIC recognizes that split accounting is a problem for less-equipped entities. However, the OIC prefers view 2, because it is important that the entities should be aware of the risks related to structured and complex financial instruments, especially in a contest in which those type of products are becoming more relevant also for SME.

In case of adoption of "view 1", it should be useful and correct that the entities give the necessary disclosure of the presence of "complex" products and their relevant amounts/figures.

In addition, with regards to compound financial instruments, the complexity of the accounting principles laid down in IAS 32 leads us to also suggest eliminating provision for puttable instruments for SMEs. Such instruments should be entered as equity instruments irrespective of the options granted to the security holder.

Questions to EFRAG constituents:

1. Are securitization and factoring transactions common transactions for SMEs? Is the simplification made by the IASB appropriate?
2. If not, what accounting guidance should be provided?

The OIC agrees with the simplification of the derecognition process that must be followed in all normal and standard transactions typically carried out by SMEs, in particular with regard to the elimination of continuing involvement. The OIC suggests to modify the wording in paragraph 11.24 (b) "the entity transfers to another party all of the significant risks and rewards relating to the financial asset" with the one used in IAS 39, paragraph 20 (a) "the entity transfers substantially all the risks and rewards of ownership of the financial asset".

It must be pointed out that in Italy securitization is uncommon for SMEs, while factoring is common. In case of relevant factoring transaction that fall under the rules of continuing involvement as provided for by IAS 39, the OIC thinks that the entities should comply with IAS 39, according to paragraph 10.4., in order to give a better representation in the financial statement.

Questions to EFRAG constituents:

The simplified hedging approach goes along with some restrictions which might cause problems in practice:

1. Sec. 11.31 only allows hedging for four specific risks. Is that too restrictive ?
2. Sec. 11.32 only allows hedging for certain hedging instruments. Is that too restrictive ?

The OIC supports the simplifications of hedge accounting as provided for by IAS 39 since they can be considered appropriate for SMEs and supports EFRAG's comments.

With reference to the four specific risks allowed in paragraph 11.31, they represent standard risks typically hedged.

With reference to the terms and conditions listed in paragraph 11.32, they can be considered contractual parameters to ensure that the hedging instruments be highly effective in offsetting the designated hedged risk. The content of this paragraph "implicitly" allows the possibility to use the "shortcut method".

The OIC agrees that the measurement of a finance lease should be "at an amount equal to the present value of the minimum lease payments and not at fair value" given that the former is in any event a necessary value for subsequent measurements of the financial effects of the leasing.

The OIC agrees with EFRAG's criticism of the Board's decision to change the definition of recoverable amount for impairment purposes, eliminating the reference to "value in use". The provision of section 26 that considers recoverable amount to be equal to fair value less costs to sell does not seem reasonable. It is illogical to believe that fair value can represent the recoverable amount of an asset held to remain in the entity's possession for a long time (e.g. PP&E or an intangible asset). For these types of assets, it is more logical to refer to value in use. This is a value that for such assets is usually easier to determine and one that is almost always, considering the use, more credible. For a stakeholder, knowing the value in use of plant is more meaningful than its presumed disposal value.

In this regard, the OIC supports EFRAG's proposal to define recoverable amount as the value in use for those assets destined to remain in the entity's possession for the long term, and disposal value for those assets due for disposal. Where there is an active market, the disposal value will be equal to the fair value less costs to sell; while it will represent the expected selling price where there is no active market.

The OIC agrees with EFRAG's criticism concerning intangible assets with an indefinite life and their non-amortizability.

Reasons of simplicity suggest eliminating the distinction between intangible assets with finite or indefinite useful life. They should all be subject to amortization, so avoiding continual and complicated checks to ascertain whether assets with indefinite life should be written down or not. In this way, it will be possible to reduce the administrative burden of a procedure that does not appear to provide such significant information in the case of entities of no public significance. There could be a standard period, set by convention, for the amortization of goodwill. In any event, in the presence of objective evidence of loss, a write-down would be necessary. However, this would be a procedure to be applied as necessary and not continually, as is instead necessary when the amortization of goodwill is not provided for.

Section 16 requires that an entity re-consider at least once a year the residual value of PP&E. This appears unnecessarily burdensome for SMEs as it requires repeated estimates of what could be the recoverable amount and, hence, consequent modifications of the amount to be amortized. It would be sufficient to require that the residual value be adjusted only when there is objective evidence to believe that it has been significantly modified (reduced). Thus, there is no need for the calculation to be made every year. In the absence of a market with readily observable prices, it is easier to maintain the initially estimated amount rather than attempting to determine the fair value

recoverable amount every year. This is especially the case when the asset is measured using the cost model.

The ED devotes a significant part of section 36 to discontinued operations. The OIC favours eliminating the accounting requirement for such operations as they are not typical of SMEs. Therefore, the provision of a specific discipline is not necessary.

Section 20 of the ED regulates the accounting treatment of government contributions. In addition to not being wholly clear, the treatment as specified therein appears innovative compared with the rules as laid down in IAS 20. The setting of principles that are clearer and simpler is to be desired. In this regard, the preference of the OIC is for the accounting of public contributions to be consistent with the current IAS 20.

Question 3 – Recognition and measurement simplifications that the Board considered but did not adopt

Should the Board reconsider any of those and, if so, why?

The OIC agrees with the EFRAG proposal on the need to regulate share-based payments to employees. This is an issue that does sometimes concern non-publicly-accountable entities. However, given the typology of entity concerned and the stakeholder categories involved, providing disclosures on such operations and on their possible diluting effects on share capital would appear to be sufficient.

Question 4 – Whether all accounting policy options in full IFRSs should be available to SMEs

Do you agree with the Board's conclusions on which options are the most appropriate for SMEs? If not, which one(s) would you change, and why?

Should any of these options that would be available to SMEs by cross-reference to the full IFRSs be eliminated from the draft IFRS for SMEs and, if so, why?

The OIC agrees with the proposal put forward by EFRAG. Generally speaking, it believes that the options recognized in the full IFRSs should also be available to entities that apply the IFRS for SMEs. However, such options should be recognized by direct inclusion in the document on SMEs and not through the use of cross-references.

The OIC agrees with the suggestions proposed by EFRAG, except for the accounting of public contributions. The OIC deems it preferable that such accounting should be on the basis of the current IAS 20. In the opinion of the OIC, it would not be appropriate to use the SME project to introduce future application rules for entities that apply the full IFRSs. Moreover, the rules of IAS 20 concerning public contributions do not seem so complicated as to justify abandoning them for other innovative provisions.

The ED allows the use of three measurement methods (cost, equity method and fair value) for determining the value for associates and joint ventures. Fair value does not appear useful given that it is complex and difficult to determine. Moreover, it is not common for non publicly accountable entities to hold stakes in associates or joint ventures that are traded in active markets. For reasons of simplicity, together with those of consistency and hope of a limited use of the fair value criterion, it is to be desired that such investments be measured either at cost or by the equity method. In this regard, a re-consideration also by EFRAG is to be desired (page 7 of attachment 2).

The OIC believes that, when there is an option to choose between two measurement criteria (e.g. the cost model and the revaluation model for PP&E), it is appropriate to require that also for SMEs the choice be homogeneous within the category, and not item by item, this in order to avoid the risk of abuses by preparers. In this regard, the OIC does not agree with the approach proposed by

EFRAG under which the application of the model would be on an “asset by asset” basis if this expression means item by item, in order to avoid the risk of cherry-picking.

Concerning measurement, the OIC believes that when the revaluation model is allowed, the increase in value should go directly to the reserves, similar to the treatment under the full IFRSs. EFRAG’s proposal to ascribe such an increase in value directly to the profit and loss account does not seem to be a simplification given that European entities would in any event have to monitor that gain in the separate financial statements in view of the distribution issues relating to the provisions of EEC Directive II.

Question 5 – Borrowing costs

Do you agree or disagree with the proposal to allow SMEs to choose rather the ex-pense model or the capitalisation model for borrowing costs, and why?

The OIC agrees with EFRAG’s proposal to retain the option to use either the expense model or the capitalization model for borrowing costs on the basis of the reasons given.

Question 6 – Topics not addressed in the proposed IFRS for SMEs

Should any additional topics be omitted from the IFRS for SMEs and replaced by a cross-reference? If so, which ones and why?

The answer is no. We refer the reader to our response to Question 1 for the explanation of why we wish cross-references to be eliminated.

Question 7 – General referral to full IFRSs

Are the requirements in paragraphs 10.2 – 10.4 coupled with the explicit cross-references to particular IFRSs in specific circumstances appropriate? Why or why not?

The OIC agrees with the comment given by EFRAG.

Question 8 – Adequacy of guidance

Are there specific areas for which SMEs are likely to need additional guidance? What are they and why?

The OIC agrees with points made by EFRAG concerning the appropriateness of restructuring the document, separating the general application principles from the guidance. A re-organization of the document would enable, on the one hand, repetitions in the principles to be avoided, and, on the other, a larger number of application guides to be provided. This would be a way of better calibrating the document to the type of entity concerned and to one that is less equipped and skilled in the field of accounting principles and their application.

Question 9 – Adequacy of disclosures

Are there disclosures that are not proposed that the Board should require for SMEs? If so, which ones and why? Conversely do you believe that any of the proposed disclosures should not be required for SMEs? If so, which ones and why?

Generally speaking, the OIC favours a significant reduction in the information to be disclosed in the financial statements of SMEs. The information to be disclosed should be concise and simple. Unlike for listed companies, it does not seem possible to justify the requirement for more complete and complex disclosures, which increase the costs of preparing the financial statements while being of limited use in stakeholder decision-making in view of the reduced importance of investors and financial analysts.

Therefore, the whole document should be reconsidered, making the necessary simplifications concerning the disclosures required.

Part of the simplifications concerning disclosure would stem from the introduction of simplifications concerning the entry and measurement of the elements of the financial statements. If it were decided to apply amortization for all intangible assets, regardless of distinctions between intangible assets with definite or indefinite life, then paragraphs 17.29, 17.33 a) and 18.21 should be eliminated and others should be re-formulated.

Furthermore, the OIC wishes to draw attention to two specific points.

First, the OIC does not agree with the requirement for disclosure concerning earnings per share as this would be of little use to an SME compared with the costs incurred in determining it. We suggest that section 34 be eliminated.

Second, the OIC believes it appropriate to require a specific disclosure on share-based payments to employees. These types of payments do sometimes take place among non-publicly-accountable entities and, therefore, they should be adequately explained. It is important to have full understanding of their possible diluting effects on share capital. Given the typology of entity in question, the stakeholder categories concerned and the complexity of IFRS 2, it would be sufficient to provide a note on such operations, without the need for adopting specific recognition and measurement criteria on the matter.

Question 10 – Transition guidance

Do you believe that the transition guidance is adequate? If not, how can it be improved?

The OIC agrees with the comments given by EFRAG.

Question 11 – Maintenance of the IFRS for SMEs

Is the approach to maintaining the IFRS for SMEs appropriate, or should it be modified? If so, how and why?

The adoption of an IFRS for SMEs is appropriate because it will enable these entities to prepare financial statements that better satisfy their own users' needs. For this kind of entity, this document seems more suitable than the full IFRSs in terms of costs and benefits. However, the ED currently under discussion is still too similar to the full IFRSs. Therefore, further simplifications are recommended. If the aim is to produce an IFRS that really is appropriate for SMEs, then it must be an *autonomo corpus* (or self-contained set) of accounting principles, which should be updated on the basis of a specific project at regular intervals (e.g. every 4-5 years). For this reason, it is necessary to avoid cross-references, which would result in more frequent updates by stealth given the frequent modifications that "full IFRSs" undergo.

Questions to EFRAG constituents:

Transactions that do not affect accounting or taxable profit on the initial recognition

Different from IAS 12.15(b) and 12.24(b) Sec. 28.15 and 28.16(a) allow an SME to recognise deferred tax asset and liabilities for all temporary differences arising on the initial recognition of an asset or liability outside a business combinations regardless whether the transactions at that time affects accounting or taxable profit.

1. Do constituents think this is appropriate ?
2. Does this cause any problems considering your national tax environment ?

General simplification of deferred taxes

3. Do you have proposals to further simplify deferred tax accounting ?

The OIC is of the opinion that stating of a principle for deferred taxation that differs from that under IAS 12 does not represent a simplification. On the contrary, it would make the financial statements

of SMEs less intelligible and comparable. The OIC favours extending the provisions of IAS 12 to include SMEs as well. This solution would be in line with the taxation accounting approach that has been used in Italy for years also for SMEs, without causing them management difficulties or complexities.

Yours sincerely,

Prof. Angelo Provasoli

(OIC – Chairman)