

Paul Pacter
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International Accounting Standards Board
30 Cannon Street
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United Kingdom

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Dear Mr Pacter,

International Accounting Standards Board's Staff Questionnaire on *Possible Recognition and Measurement Modifications for Small and Medium-sized Entities (SMEs)*

The Swedish Accounting Standards Board, hereafter referred to as BFN, is the authority responsible for issuing standards for unlisted entities in Sweden. We appreciate the invitation to comment on your questionnaire on SMEs. BFN is interested in participating in the round-table meetings in September.

BFN is presently actively discussing standards for SMEs. Our present thoughts in this area is based on issuing two different sets of standards, one for SMEs that do not exceed more than one of the following criteria: 50 employees, approximately 2.5 million euros in assets and approximately 5.0 million euros turnover and one for SMEs that exceed more than one of the criteria. Our response to your questionnaire is based on our thoughts on the latter.

In answering your questionnaire we have assumed that the same principles should apply to both consolidated and individual accounts.

Question 1

BFN is of the opinion that simplifications should be made in standards for SMEs in the areas discussed under paragraph c,f,h,i,j,l,m,n,o,p and r.

- a) *Inventories*. We do not see any problems for SMEs to apply IAS 2.
- b) *Percentage of completion*. We believe that the percentage of completion method rather than the completed contract method should be required both for construction contracts and for service providers. We recognize that the

percentage of completion method requires a fairly advanced accounting system. On the other hand it is important that contract revenue and costs are allocated to the periods in which the work is performed especially for entities in the building industry.

- c) *Deferred income tax.* We are generally in support of recognizing deferred income taxes for SMEs based on the methodology in IAS 12. However, our experience is that only in rare circumstances is it possible to “provide convincing evidence that sufficient taxable profits will be available against which unused tax losses can be utilized”. Therefore we suggest that SMEs should not be allowed to recognize a deferred tax asset related to losses on net basis (i.e. a deferred tax asset should only be recognized to the extent there is a deferred liability that the asset can be offset against) if the entity has reported a loss in any of the last two years.
- d) *Lease accounting.* We have debated whether SMEs should be allowed to classify all lease contracts as operating. Our experience is that this is what most entities do. However, we are of the opinion that it is important to recognize the liability to the lessor and have therefore reached the conclusion that it is not too onerous to require that SMEs apply the principles in IAS 17.
- e) *Defined benefit pension liabilities.* We recommend that SMEs apply the principles in IAS 19 as we can not envisage an alternative that would simplify the accounting treatment and still provide comparability. However, we believe that the rules have to be written in a more understandable and shorter way.
- f) *Consolidation under IAS 27.* Our experience is that it is almost as common among SMEs to have subsidiaries as among listed entities. Therefore we believe that a standard for SMEs should include IAS 27.
- g) *The equity method.* We are of the opinion that the equity method should be used when accounting for associated entities and should be an alternative when accounting for joint ventures.
- h) *Impairment of goodwill.* To require an impairment test for intangibles with an indeterminate life is likely to prove burdensome to SMEs. Therefore, we are in favour of amortizing such assets in accordance with the old IAS 38, i.e. over useful life not exceeding 20 years. An impairment writedown should be recognized only when it is obvious that the carrying amount is substantially higher than the recoverable amount.
- i) *Impairment of PPE.* IAS 36 is one of the most difficult standards to apply for SMEs. One way of simplifying the standard could be to limit the indications in IAS 36 to 12b), e) and f), i.e. indications other than those that relate to interest rates etc. We believe that it is also important that a decision to write down the value of PPE should be based on a valuation of the individual asset rather than a cash-generating unit.
- j) *Provisions and contingencies.* We believe that IAS 37 should be included in a standard for SMEs. The most difficult part of the standard is the section on measurement that calls for an expected value and a risk-adjusted discount rate. We believe that the application of the standard would be considerably

simplified by requiring the measurement to be based only on the most likely outcome.

- k) *Capitalization of intangibles.* We believe that it is important for SMEs to be able to capitalize intangibles, in particular development costs, provided the criteria for initial recognition in IAS 38 are met.
- l) *Effective interest method.* We believe that the effective interest method as defined in paragraph 9 in IAS 39 should also apply to SMEs. However, in order to simplify the calculations we would support a proposal to limit the application of the effective interest method to cash flows extending for more than two years.
- m) *Fair value measurement under IAS 39.* We believe that fair values should be limited to financial assets and only when the fair values can be ascertained by references to an active market. We are afraid that a possibility to base the valuation on valuation models rather than prices set in active markets, would introduce great uncertainty.
- n) *Foreign currency forward contracts.* In our opinion, the requirement to account for changes in the fair value of instruments hedging future cash flows in equity is difficult to understand for many SMEs. We would therefore prefer that SMEs are allowed to use deferral hedge accounting for their forward contracts.
- o) *Derecognition and/or hedge accounting in IAS 39.* We believe that the requirements for derecognition in IAS 39 should apply also to SMEs. As to hedge accounting we have discussed two alternatives without reaching a firm conclusion. One solution would be to require fair values for all financial instruments where there exists an active market. As this would include some derivatives it would be inconsistent to permit deferral hedge accounting for cash-flow hedges. The alternative would be to require fair values but with an exception for hedge accounting where all hedges, including hedges of fair values, would be based on the deferral method.
- p) *Fair value for biological assets.* In our opinion, it is doubtful whether fair values can be reliably determinable for most biological assets and agricultural produce. Therefore, we would support the cost method for those assets.
- q) *Share-based payments.* We would expect share-based payments in an SME to be so rare that there is no need to discuss special rules for those entities.
- r) *Changes in accounting principles.* We would recommend that if an SME changes an accounting principle this should be accounted for prospectively. Our experience is that a retroactive application often is burdensome but we believe that it should be an option.

Question 2

BFN is of the opinion that the topics addressed in paragraph 1, 3, 5, and 12 may be omitted from SME standards because they are unlikely to occur in an SME context.

1. *IFRS 2*. We support deleting IFRS 2 from an SME standard as we do not believe that unlisted entity is likely to use their own equity instruments to pay for goods and services.
2. *IFRS 3*. In our experience, business combinations are as common among SMEs as among listed entities. Therefore, we believe that IFRS should be included in a standard for SMEs and that most of the requirements in IFRS 3 are applicable to SMEs. Topics that we believe could be deleted relate to the recognition of contingent liabilities and the recognition of the acquiree's intangible assets. We would also support to reintroduce amortization of goodwill over a period not exceeding 20 years.
3. *IFRS 4*. We support deleting IFRS 4 from an SME standard.
4. *IAS 11*. We believe that the sections on combining and segmenting contracts in IAS 11 should be included in an SME standard.
5. *IAS 12*. We support deleting the requirement to account for temporary differences arising from investments in subsidiaries etc. from an SME standard.
6. *IAS 16*. We believe that IAS 16 should be included in a standard for SMEs. However, we oppose the possibility to revalue PPE as, possibly with an exception for real estate, it is not possible to reliably assess the fair value.
7. *IAS 17*. We believe that a section on sale and leaseback transactions should be included in a standard for SMEs.
8. *IAS 19*. We believe that IAS 19 should be included in a standard for SMEs.
9. *IAS 23*. We believe that capitalization of interest costs can be important to SMEs acquiring or producing qualifying assets and therefore that IAS 23 should be included in a standard for SMEs.
10. *IAS 26*. We believe that the principles in IAS 26 should be included in a standard for SMEs.
11. *IAS 27*. We do not agree that SMEs generally have no subsidiaries. Therefore, we believe that a standard for SMEs should include definitions on subsidiaries etc. based on IAS 27.
12. *IAS 30*. We agree that there is no need to include IAS 30 in a standard for SMEs.
13. *IAS 32*. We believe that there is a need to include a section on split accounting in a standard for SMEs.
14. *IAS 36*. Since we are of the opinion that SMEs often enter into business combinations we believe that there is a need to clarify how goodwill should be accounted for in a standard for SMEs and that goodwill can be subject to impairment even if, as we would support, goodwill is amortized over a relatively short period.
15. *IAS 38*. Because of the importance of intangibles, we believe that IAS 38 should be included in a standard for SMEs. A change that we would like to see is a prohibition to revalue intangibles.
16. *IAS 39 on derecognition and hedging*. Because of the importance of financial instruments we believe that IAS 39 should be included in a

standard for SMEs. We support the general requirements on derecognition and hedge accounting. However, we would prefer that deferral hedge accounting should be reintroduced at least for cash flow hedges and possibly for all hedges.

These comments were prepared by BFN in a plenary session.

Hans Edenhammar
Chairman

Gunvor Pautsch
Head of Secretariat