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SME Comment Letters
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Comment Letter on the Exposure Draft of a Proposed IFRS for SMEs

Dear Members of the IASB,

On behalf of the international co-operative community of 800 million members, I am writing to you to comment on the Exposure Draft of a Proposed IFRS for SMEs.

The International Co-operative Alliance (ICA), established in 1895, is an association of 230 national co-operatives in 92 countries. **A majority of co-operatives being SMEs, we are highly concerned by the IASB proposed IFRS for SMEs and wish to be fully associated and consulted on this project and invited to the round-table discussions**.

Changes in accounting standards over the past few years have created big challenges for cooperatives. Even though we understand the advantages of creating a unique set of international financial reporting standards for SMEs, it appears to us that some of these standards are not relevant or useful for SMEs and particularly for cooperatives.

Indeed, IFRS for SMEs are based on full IFRS: the implementation and use of IFRS for SMEs would require a knowledge and understanding of the full IFRS, which would be difficult for small and medium-size entities which financial and human resources are far less developed than those of listed companies. We are concerned that the cost and burden of preparing financial statements compliant with IFRS for SMEs would be too high for many SMEs, and not counterbalanced by clear benefits.

If a set of IFRS is to be developed for SMEs, it should be elaborated on the basis of the needs of SMEs and not limited to a simplification of the full IFRS. This is particularly true for co-operatives, which have big differences with capital-market oriented companies for which the IFRS were conceived. As co-operatives constitute a significant part of the SME sector in many countries, it is essential that their characteristics are taken into account in the elaboration of an IFRS for SMEs.

To be more specific, 2 issues are particularly important for cooperatives:

1) **The classification of co-operative member shares under IFRS for SMEs** (Section 2 and 21 of the Exposure Draft)

2) **The accounting method for business combinations under IFRS for SMES** (Section 18 of the Exposure Draft)

1) <u>The classification of co-operative member shares under IFRS for SMEs</u>

<u>(Section 2 and 21 of the Exposure Draft)</u>

The accounting treatment of cooperative shares according to section 2 and 21 is rather unclear. This definition might exclude financial instruments that have been subject to redemption in the past and have as a consequence created a reasonable expectation for their holders that they will be redeemed in the future.

While most cooperatives have a practice of redeeming members' shares upon the members' withdrawal from the cooperative, some of them give their boards of directors the unconditional right to refuse the redemption of these member shares, which has been recognized by the IFRIC 2 interpretation as a sufficient criterion for the member shares to be accounted for as equity.

Even if the co-operative's members have a reasonable expectation that the cooperative will redeem their shares and that the co-operative board will not use its unconditional right to refuse redemption, it should not cause these shares to be accounted for as liabilities.

As a consequence, we ask that co-operative member shares which fulfil the IFRIC 2 criterion are accounted for as equity and not as liabilities under IFRS for SMEs.

On the other hand, many co-operatives do not fulfil the IFRIC 2 criterion. Some of them fulfil the set of criteria which would allow puttable instruments to be accounted for as equity, which is currently under discussion by the IASB in the limited scope short term project on Puttable Financial Instruments and Obligations Arising on Liquidation. **The co-operative member shares which fulfil this set of criteria under IAS 32 should also be able to qualify as equity under IFRS for SMEs.**

For cooperatives, classification of their member shares as equity is essential. To classify them as liabilities would have disastrous consequences for their business and would notably hamper the creation of new cooperatives which would find themselves in the situation of having no equity at all if their shares are classified as liabilities. The classification of cooperative member shares as equity will certainly have a major impact on the acceptance of IFRS for SMEs for cooperatives.

A simple solution which could suit most co-operatives and SMEs would be to have an SME definition of equity focused on loss absorption (or participation in losses), equity being defined as capital available to the entity to cover incurred losses. This is particularly true for SMEs, which notably require capital or equity to show other parties (and notably liabilities holders) that they have through their equity the capacity to cover potential incurred losses. This approach, which is currently studied by the EFRAG's PAAinE Group, could constitute a simple alternative to a full IAS 32 transposition to IFRS for SMEs, including the IFRIC 2 interpretation and the specific puttable instruments exception.

2) <u>The accounting method for business combinations under IFRS for SMES</u>
<u>(Section 18 of the Exposure Draft)</u>

Business combinations between co-operatives are not properly accounted for using the purchase method.

According to section 18.6, applying the purchase method involves the following steps:
(a) Identifying an acquirer
(b) Measuring the cost of the business combination on a full fair value basis of and
(c) Allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and contingent liabilities assumed.

This method does not reflect the reality of mergers between cooperatives. It implies accounting techniques that are vastly burdensome and almost impracticable for cooperatives as for most other SMEs.

Indeed, there is no identified acquirer and acquiree in a merger between cooperatives and there is no change in control as members, who are the owners of the co-operative, have the same voting rights before and after the merger. There is also no exchange of consideration and no exchange of member interests in a merger between cooperatives.

Determining fair value can be a costly and burdensome process without any attendant benefits for cooperatives, particularly for SMEs. The pooling method has served cooperatives and users of cooperative financial statements well. There is little evidence that the pooling method – as it applies to cooperatives – has caused lack of comparability or problems for users. It is simple and produces consistent results. Regarding cost-benefit aspects, accounting methods based on historical costs or pooling of interests are far more appropriate for SMEs than the purchase method.

As a consequence, the pooling of interest method is far more relevant for mergers between co-operatives, particularly for SMEs, than the purchase method which is not adapted to their legal form.

We look forward to continue our work with the IASB to ensure that accounting standards address the needs of the international cooperative community.

Yours sincerely,

Ivano Barberini
President of the ICA