



European Federation of Accountants and Auditors for SMEs

Commissioner Lord Jonathan Hill
European Commission
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Dear Commissioner Lord Hill

EFAA Response to the European Commission's Green Paper – Building a Capital Markets Union

The European Federation of Accountants and Auditors for SMEs (“EFAA”) represents accountants and auditors providing professional services primarily to small and medium-sized entities (“SMEs”) both within the European Union and in Europe as a whole. Constituents are mainly small practitioners (“SMPs”), including a significant number of sole practitioners. EFAA’s members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs.

EFAA appreciates the opportunity to respond to European Commission’s Green Paper – Building a Capital Markets Union.

General Remarks

We welcome the Green Paper and invitation to respond on this topic which addresses, as reported by numerous EC surveys, one of the biggest challenges faced by SMEs. The issue of access to finance for SMEs is complex, not least because SMEs, as represented by our organisation, range from the smallest of one-person enterprises up to entities with 249 employees. Within this size range, SMEs have very different financing needs – the smallest will generally rely on debt including bank loans, leasing and alternative funding such as crowdfunding; whereas the latter may access the more traditional ‘capital markets’ by listing debt or even equity.

The Green Paper addresses some of the differing needs of this range of entities but in some places focusses on the larger end of the range, such as listed SMEs or those seeking private placements. We have developed our responses to the Green Paper in the context of all SMEs, from the largest to the smallest.

Responses to Specific Questions

Our responses to the specific questions raised are set out below. We have also submitted them through the online questionnaire.



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Q1: Beyond the five priority areas identified for short term action, what other areas should be prioritised?

EFAA believes that improving the quality, availability, comparability and relevance of financial information on SMEs is a key priority; EFAA agrees with the analysis in the Green Paper that the absence of such information for most SMEs significantly restricts their ability to participate in the capital market. Measures to improve the supply of such information will complement the efforts to address each of the five priority areas identified. To improve such information, it will be necessary to prioritise improving the financial literacy of preparers and users of such financial information for SMEs. Small and Medium-sized accounting Practitioner firms (SMPs), such as those represented by EFAA, have both relevant expertise and existing relationships with SMEs and are well placed to assist in realizing such improvements. EFAA is keen to work with the EC in addressing this priority.

Q2: What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?

EFAA notes the role that SMPs play in supporting SMEs in producing financial information, which forms a key part of the credit information on SMEs. Barriers which SMEs face in producing such information include a lack of financial literacy, lack of knowledge of the capital markets and sometimes a lack of appreciation of the range of available financing opportunities. SMPs assist SMEs by providing specialist skills in producing financial information and knowledge of financing solutions. However, SMPs themselves face barriers in providing effective assistance, including a lack of financial literacy in counterparts such as bankers and investors, and a lack of willingness or ability of capital providers to finance SMEs.

The Green Paper calls for a ‘Set of comparable information for credit reporting’. Challenges in achieving this include the difficulties associated with banks and others being able to agree on the appropriate content of the standardised comparable credit information. EFAA is keen to explore how the required information might interact with information prepared under existing accounting standards that are in place in various forms throughout the EU; in many cases, the base financial information is not currently standardised or comparable between countries because of the implicit and explicit options included within the Accounting Directive. Should the standardised form of comparable information for credit reporting be adapted from existing accounting standards, such as IFRS for SMEs and national GAAPs, or should it replace or be separate from such existing standards? EFAA believes it should build upon such existing standards so as to utilize the existing infrastructure for accounting standards which is available to SMEs supported by SMPs within the internal market. The same principle holds for other standardized financial information suggested in the Green Paper, such as to support the Private Placement market and the ‘single accounting standard’ suggested in Question 8.

Channels for SME finance and investment can include through intermediaries (venture capital, hedge funds etc.) or provision direct to the SMEs (loans, leasing, factoring etc.), in addition to the relatively rare capital provision through investments in SME equity or SMEs listing debt or equity. The needs and financial literacy capacity of providers of such finance must be paramount in the development of any standard(s) for SME credit information.

A further issue to be explored is the degree to which any standardized information should be independently verified or verifiable, such as through some sort of financial audit or standardized verification. Again, the existing



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infrastructure and capacity of SMPs should be utilized rather than attempting to create a completely new infrastructure.

Q5: What further measures could help to increase access to funding and channeling of funds to those who need them?

EFAA believes that measures to stimulate SME access to alternative funding to traditional bank loans are key, such as measures to increase SME's ability to access innovative approaches to leasing, factoring and other non-bank financing.

Measures are needed to facilitate SMEs in accessing the support they need to address the information gaps correctly identified in the Green Paper – such as support for SMEs to access the expertise of SMPs to assist on identifying and accessing suitable funding sources. Such measures could include direct support for the costs of consultancy, such as in the UK Government's current SME business voucher scheme, and other similar measures.

The Green Paper suggests that standardization of rules, regulation and information, is a mechanism to kick start markets. However, additional measures to stimulate the willingness of lenders to lend in practice to SMEs will be needed in addition to standardization; possible measures for consideration might include some form of guarantees or insurance for banks specific to their SME lending, policies to support leasing, and other similar measures.

Q8: Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

Recent developments in EU legislation emerging from amendments to the Accounting Directive have resulted not only in a reduction in accounting and financial reporting requirements for SMEs but also a lack of comparability due to the significant number of member state options that remain within the Accounting Directive.

Against this backdrop, the need for more information to be provided by SMEs (including the potential to provide non-financial information) in a standardized manner to enable access to capital markets is correctly identified in this Green Paper. Because of this, and in response to the question, EFAA believes that there is great value in considering whether to develop a common EU level accounting standard for SMEs listed on MTFs but that one should also consider the use of an existing standard or existing standards in the first instance.

We say this because EFAA believes that there are three possible solutions to this challenge as outlined below.

- (1) Use EU-endorsed IFRS
- (2) Use IFRS for SMEs
- (3) Introduce a new accounting standard for those SMEs listed on MTFs

EFAA is developing a paper to address, in detail, the pros and cons of the above options. We hope that this will provide insight to the debate from the perspective of drawing on the expertise and experience of SMPs and SMEs throughout Europe.



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However, as an overview we are able to make the following observations.

Use of EU-endorsed IFRS

There is a challenge to applying EU-endorsed IFRS to relatively small entities. These challenges have already been voiced by stakeholders and speak to the ability of EU-endorsed IFRS to be applied in a proportional manner. If proportional application is not feasible, then many would question whether this standard would be truly relevant and hence appropriate for those SMEs listed on MTFs.

IFRS for SMEs

IFRS for SMEs has not proved overly popular within the EU political sphere. There is little doubt that IFRS for SMEs has accounting merit and this has been proven to some degree by the use in, or adaption of IFRS for SMEs for use in, some EU member states.

However, any introduction of IFRS for SMEs within the EU would firstly require the political challenges to be overcome and secondly would require a thorough review by the EU of the need for a suitable endorsement mechanism similar to that currently undertaken for EU-endorsed IFRS which involves EFRAG and the ARC. Additionally, as written, the scope of IFRS for SMEs excludes any entities with public accountability which would seem to include those listed on MTFs.

New accounting standard for SMES on MTFs

The third option, the implementation of a new accounting standard, might enable an SME relevant and appropriate standard to be developed as it offers a chance to consider a new and possibly radical approach which could produce financial information more tailored to the needs and financial literacy capacity of SME finance providers. This information could in addition include relevant non-financial information along the lines of that embodied within Integrated Reporting (e.g. about the business's strategy, non-financial assets, the business model and its attitude to risk and sustainable growth etc.) that would be of interest specifically to finance providers. In short, such a standard might result in the production of information that is useful and understandable by SMEs owners, SME staff and the range of potential SME funding providers.

However, it is clear to EFAA that any new accounting standard could and should be based on traditional accounting standards, given the existing infrastructure and capacity to support SMEs. What is also clear is that the development of any such standard would cost money and take time and together these aspects represent significant barriers to overcome.



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Q9: Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

Crowdfunding and peer to peer platforms rely on the availability of reliable financial information; the lack of such information for many SMEs is a barrier. The measures discussed in the Green Paper and in this response to facilitate an improvement in SME financial information will help address this barrier for SMEs.

Q10: What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

EFAA believes that institutional investors can best be encouraged to invest in SMEs only via dedicated intermediaries, such as venture capital funds or hedge funds, or through financial instruments such as securitisation. Other sections of the Green Paper address actions to promote such intermediaries and instruments. In this regard, EFAA members assist in the production of financial information (with comparable information) to support such intermediaries and instruments.

Q16: Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

EFAA agrees with the analysis in various sections of the Green Paper that the lack of standardized but relevant financial information on SMEs is a major impediment to safely increasing lending to SMEs across borders. Safety of lending is further increased where some or all of the information to be relied on in the lending process can be independently verified (e.g. through an audit or similar review). Requirements for financial reporting by SMEs supported by audit have in the past provided a mechanism to produce such information, but such requirements have been much reduced over time. Analysis throughout the Green Paper points to the need for some form of similar mechanism on the production of standardized financial information for SMEs to be re-implemented, though possibly as a market-driven solution rather than a formal legal requirement.

Q19: What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

Measures to increase and foster financial literacy are key to increasing retail investment. Such literacy is needed directly by citizens; and citizens can and often do access literacy through consulting with advisers (accountants, Independent Financial Advisers etc.). Policy measures to promote financial literacy are needed.



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Q32: Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

As noted in our response to Question 1, EFAA believes that improving the quality, availability and relevance of financial information on SMEs is a key priority. EFAA agrees with the analysis in the Green Paper that the absence of such information for most SMEs significantly restricts their ability to participate in the capital market. Measures to improve the supply of such information will complement the efforts to address each of the five priority areas identified. To improve such information, it will be necessary to prioritize improving the financial literacy of producers and users of such financial information for SMEs. SMPs, such as EFAA members, have existing relationships with SMEs and are well placed to assist in realizing such improvements. EFAA is keen to work with the EC in addressing this priority.

Lastly, we note that the Green Paper addresses one important aspect of access to finance in its considerations and focus on a Capital Markets Union. However, as we stated in our general remarks above, the issue of access to finance for SMEs within the EU is itself a much wider challenge. Barriers or constraints that inhibit SMEs access to finance and therefore restrict growth for EU SMEs are themselves worthy of further deliberation.

I trust that the above is comprehensive but should you have any questions on our comments, please do not hesitate to contact me.

Yours sincerely,

Bodo Richardt
President