



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

1 August 2007

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Our ref: ICAEW Rep 66/07

Your ref:

Mr Peter Godsall
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By email: iasbsme@frc-asb.org.uk

Dear Peter

IASB EXPOSURE DRAFT OF A PROPOSED IFRS FOR SMES

The Institute of Chartered Accountants in England and Wales ('the Institute') is pleased to respond to your request for comments on the consultation paper *IASB Exposure Draft of a Proposed IFRS for SMEs*.

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW Representation

ICAEW REP 66/07

IASB EXPOSURE DRAFT OF A PROPOSED IFRS FOR SMES

Memorandum of comment submitted in July 2007 by The Institute of Chartered Accountants in England and Wales, in response to the Accounting Standards Board consultation paper *IASB Exposure Draft of a proposed IFRS for Small and Medium-sized Entities*, published in February 2007.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the invitation to comment (ITC) published by the Accounting Standards Board ('the Board') on the consultation paper *IASB Exposure Draft of a proposed IFRS for Small and Medium-sized Entities*).

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures that these skills are constantly developed, recognised and valued.

MAJOR POINTS

Summary

4. We continue to support the notion of convergence between UK GAAP and IFRS and believe that there is a role for the IFRS for SMEs in the UK. We thus welcome the Board's initiative in highlighting the potential implications for the UK of the IASB proposals, and have set out below our observations and reservations in this regard. In summary:
 - We support the use of the IFRS for SMEs by a 'middle tier' of UK entities; however, the term 'middle tier' requires some clarification. It is unclear where some UK entities would fit within the structure for UK GAAP proposed in the Board's consultation (see paragraphs 5 to 8 below);
 - The proposed standard will in any case require some significant changes by the IASB before it is suitable for use in the UK (see paragraph 12 below);
 - In its current form, the proposed standard is not suitable for small, and in particular, 'micro' entities (see paragraphs 14 to 16 below); and
 - When determining the scope, nature (e.g. mandatory/optional) and timing of any proposals for convergence-related changes in small company accounting, the Board should assess very rigorously the costs and benefits involved for the sector and for users of small company financial statements (see paragraph 17 below).

The Place of the IFRS for SMEs in the UK Framework

5. In paragraph 12 of the ITC, the Board defines the mid-tier of companies as those that are both ineligible to apply the FRSSE and not currently required to apply full IFRS. We agree in principle that these companies should move to the proposed IFRS for SMEs in the interest of simplification of the current UK accounting regime. Indeed, we prefer the cohesive approach of the IFRS for SMEs to current UK GAAP, the part-converged status of which gives rise to a number of complexities and application issues.
6. In paragraph 15, the Board states that it is “minded” not to make the IFRS for SMEs an option available for UK subsidiaries of groups that apply full IFRS. We believe that this would create an additional and unnecessary tier of reporting entities in UK GAAP. If all recognition and measurement options available under full IFRS are included in the IFRS for SMEs, as we suggest in our answer below to Question 2, then the IFRS for SMEs would be an appropriate standard for application by these subsidiaries.
7. We take this opportunity to remind the Board that issues relating to the impact of IFRS on distributable profits have not been resolved and that this currently undermines the case for extending the scope of IFRS in the UK. If these issues remain unresolved, the Board may need to modify the IFRS for SMEs before it is implemented in the UK to remove this ‘dividend trap’.
8. In addition, the Board has not articulated its views on the impact of the proposed changes on those entities (such as building societies, charities, organisations providing essential public services and small professional firms holding assets on behalf of clients) which are not eligible to use the FRSSE and are currently scoped out of the IFRS for SMEs. Full IFRS may be appropriate for large financial institutions but perhaps not for those at the smaller end of the scale. We urge the Board to address this key area of uncertainty before finally determining its policy on future convergence.
9. Under the current regime, updates to the FRSSE are derived from changes in UK GAAP. We would welcome clarification from the Board on the anticipated due process for the updating of the FRSSE in the absence of a UK GAAP reporting regime.

RESPONSES TO SPECIFIC QUESTIONS

ASB Q1: Do you believe that the proposed IFRS for SMEs would be suitable for ‘middle tier’ entities that fall between applying full IFRS and the FRSSE?

10. We fully support the use of IFRS by entities with listed securities, but have concerns over any extension of the remit of full IFRS, in view in particular of the complexity of the standards. We thus broadly agree that the IFRS for SMEs in its current form would be more suitable for application by ‘middle tier’ entities, including most private companies not entitled to use the FRSSE and, as discussed above, subsidiaries of groups that apply full IFRS.
11. We note that it will be open to individual jurisdictions, including the UK, to consider whether certain entities currently within the scope of the IFRS for SMEs but of high economic or other significance should be required to report under full IFRS.

ASB Q2: If the proposed IFRS for SMEs were to be considered a suitable basis for the middle tier companies, what specific changes do you think the ASB should be proposing; for example is it too long, is there too much cross referencing to full IFRS, are there sufficient simplifications, etc?

12. The changes we would propose are, in outline, as follows:

- Incorporation of additional guidance to create a comprehensive, standalone document. For those sections where an alternative accounting treatment is permitted but the guidance is currently cross-referenced to a full standard, a simplified version of the guidance should be incorporated into the IFRS for SMEs wherever practicable. We believe that this is a practical proposition with the notable exception of accounting for financial instruments, where reference to IAS 39 should remain as an alternative. It is recognised that adding further guidance would add to the length of the standard, but we consider that this is a price worth paying to attain a standalone document. The volume of additional material could in any case be mitigated by further simplification of the text of the full standards;
- Retention in the IFRS for SMEs of all full IFRS recognition and measurement options, albeit in a simplified form, to allow for maximum flexibility and to ensure that the IFRS for SMEs can be applied by subsidiaries that form part of a listed group;
- Exclusion of optional disclosure sections, such as those covering segment reporting, earnings per share and interim financial reporting;
- Further review and simplification of some areas, such as accounting for financial instruments and intangibles; and
- Exclusion of detail found in some sections that is unlikely to be relevant to most SMEs.

13. We will be submitting a formal, more detailed response to the IASB consultation paper in due course and will forward our comments to the Board.

ASB Q3: Do you believe that the proposed IFRS for SMEs would be a suitable replacement for the FRSSSE?

14. In our view it will not be appropriate to replace the FRSSSE with the IFRS for SMEs for some considerable time. Firstly, we believe that no decisions should be made until there has been an appropriate 'bedding-in' of the IFRS for SMEs to allow its strengths and shortcomings to be assessed. Secondly, the EU has recently published proposals for simplifying the reporting requirements for smaller entities which could alter radically the reporting regime for both small and 'micro' entities. We are at present assessing these proposals, but in view of their recent publication it has not been possible to take account of the potential implications in this submission. This question should therefore be revisited when the EU has determined its position on the reporting requirements for small companies and sufficient evidence is available to measure the success or otherwise of the IFRS for SMEs. At that time it may be appropriate for the IFRS for SMEs to replace the FRSSSE.

15. In this context we propose that the FRSSE is currently retained for small entities only, i.e. its scope is not extended to medium-size entities, as has been proposed. Keeping the FRSSE focussed on small entities should enable the Board to keep its requirements simple - without needing to consider the expectations of users of financial statements of entities at the top end of the medium-size range.

ASB Q4: If the proposed IFRS for SMEs were to be considered a suitable basis for the FRSSE, what specific changes do you think the ASB should be proposing; for example is it too long, is there too much cross referencing to full IFRS, are there sufficient simplifications etc?

16. As stated in our response to Question 3, at present the proposed standard is not a suitable replacement for the FRSSE. For the IFRS for SMEs to be suitable for all non-publicly accountable entities, a certain degree of complexity will be unavoidable to accommodate larger companies. We are not convinced that this circle can be squared. Radical simplification would be necessary, including - but not restricted to - the changes outlined in our response to Question 2 before the proposed IFRS for SMEs was suitable for very small companies. A structure that highlights key and common areas early on in each section and relegates more complex/peripheral points to the end of the chapter/document would be helpful for smaller entities that conduct only less complex transactions; it would be absolutely essential if the standard were to replace the FRSSE.

ASB Q5: What do you consider should be the costs and benefits of the ASB adopting the proposed IFRS for SMEs either as (i) a standard for 'middle tier' companies or (ii) a replacement for the FRSSE? Are there any specific areas in the Exposure Draft that would, in your view, impose particular costs on companies? It would be helpful if any significant costs that would arise or any specified areas that could be identified and quantified.

- 17(i) For the middle-tier of companies, we believe that the short term cost associated with the move to the IFRS for SMEs would be outweighed by substantial benefits in the longer term. There will be a one-off cost on transition to IFRS for SMEs for staff training and changes to systems and software. After transition we do not foresee any significant additional costs associated with reporting under the IFRS for SMEs as opposed to UK GAAP. Indeed, in the longer term costs should fall as a simpler reporting regime - i.e. one closely aligned to full IFRS - will require fewer resources and less training. We do, however, recommend in the light of experience of the transition of listed companies to IFRS that the standard is published well in advance of the implementation date, and is not modified in the meantime unless absolutely necessary.
- 17(ii) As stated in our answer to Question 3, the IFRS for SMEs in its current form is not a suitable replacement for the FRSSE, and would involve substantial costs for very limited benefits. The possibility of deregulation for some small companies currently within the scope of the FRSSE further undermines the case for moving to a different regime in the immediate future.

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