THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

17 October 2007

Our ref: ICAEW Rep 97/07

Your ref:

Paul Pacter
International Accounting Standards Board
30 Cannon Street
London
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By email: www.iasb.org

Dear Paul

The Institute of Chartered Accountants in England and Wales is pleased to respond to the IASB's request for comments on the consultation paper *Proposed International Financial reporting Standard for Small and Medium-sized Entities*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 97/07

Proposed International Financial reporting Standard for Small and Medium-sized Entities

Memorandum of comment submitted in October 2007 by The Institute of Chartered Accountants in England and Wales, in response to the IASB consultation paper *Proposed International Financial reporting Standard 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 consultation paper *Proposed International Financial reporting Standard for Small and Medium-sized Entities* published by the International Accounting Standards Board ('the 'Board').

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 these skills are constantly developed, recognised and valued.

MAJOR POINTS

An Important Initiative

4. We applaud the Board's efforts to produce a high-quality, slimmed-down alternative to full IFRS in response to the demand from constituents, and, although we have set out below detailed recommendations for further improvement, find much to commend. The project provides an unprecedented opportunity to establish a widely-used accounting framework for private companies that wish to prepare general purpose financial statements bearing a close family resemblance to IFRS, which will encourage best accounting practice and be advantageous to:

   - Investors and lenders seeking to make comparisons between financial information published by entities in the same sectors;
   - Regulators and organisations such as the World Bank;
   - Groups with subsidiaries in more than one jurisdiction;
   - Businesses in jurisdictions that require all reporting entities to apply IFRS; and
   - The many unlisted companies that trade across national borders or have cross-border investment partners.

Small and Micro Entities

5. Our experience to date is that the complexity of full IFRS taxes the resources and capabilities of even listed companies. We therefore anticipate that many large private companies that perceive an advantage in reporting in accordance with internationally-recognised standards will be interested in utilising this new IFRS product. Indeed, this is what we would expect and recommend in the UK.

6. As it stands, however, the standard is too complex to be suitable for application by most small companies. Indeed, the prospect of the Board producing a single

standard that met the very different user needs of the complete spectrum of unlisted businesses was always remote, and it seems unlikely that the standard will be widely-regarded around the world as a product useful for the generality of 'micro-entities', except where those entities are already required by national law to use full IFRS. Even for a 'typical' fifty-employee small company, applying the requirements of the current draft of the standard with any degree of rigour could be onerous and probably beyond its resources.

7. In failing to produce a standard suitable for micro entities, it may be argued by some that the Board has failed to meet the original demands of many of its constituents for such a product, a key driver of the project. Nevertheless, we are optimistic that the IFRS for SMEs could be used as a valuable point of reference for the development of simpler standards for use by small entities. We think it would be very helpful if the Board expanded on its views, intimated in the heading above BC108, on the possibility that individual jurisdictions might tailor the standard to provide national requirements, broadly based on IFRS, but catering specifically for the needs of the preparers and users of small entity financial statements. We note, in this context, that many jurisdictions choose not to require the smallest entities to prepare general purpose financial statements at all, an option currently under consideration in the EU.

8. The foregoing analysis leads us to conclude that the IFRS for SMEs should be renamed, as its title belies its true focus. We would prefer the title "IFRS for non-publicly accountable entities" (NPAEs), or even "IFRS for private entities".

Basis of our Response

9. The conclusion that the proposed IFRS for SMEs is likely to be of most relevance to larger reporting entities has informed our subsequent analysis of the strengths and weaknesses of the draft standard. Further, we do not think that the appeal of the current draft standard can be widened significantly. On the one hand, for the IFRS for SMEs to be suitable for larger companies, a certain degree of complexity will be unavoidable. On the other, radical simplification would be necessary before the proposed IFRS for SMEs was suitable for very small companies. We are not convinced that this circle can be squared.

10. We would, however, be pleased to assist the Board in determining the minimum additional simplifications necessary to develop a third tier product attractive to small and, in particular, micro entities. In our view this would be a much shorter and simpler document, incorporating only the simplest of the optional treatments included in the IFRS for SMEs. In most cases this would preclude inclusion of accounting treatments involving the use of fair value measurement.

A Stand-alone Product

11. The Board has gone a long way towards providing a 'one stop shop', a single standard similar in concept to the UK FRSSE, rather than, for example, adding an appendix for 'SMEs' to each full IFRS. This is very welcome. The decision to structure the standard according to topics with sections on, for example, inventories and property, plant and equipment, should enhance its practical value as – in effect – a manual of accounting.

12. We recommend, however, that the Board goes further still, by incorporating in the new IFRS the additional guidance needed to create a comprehensive, fully stand-alone product, without any cross-references to full IFRS. Where alternative accounting provisions are likely to be used only rarely or relate to more complex

optional treatments, a simplified version of the detailed material should be included in the standard for ease of use. It is recognised that, even with appropriate simplification, this course of action will add to the length of the standard, but we consider that this is a price well worth paying to attain a stand-alone document. This matter is discussed further in our response to Question 1 below.

Concepts and Principles

13. We welcome the clear and concise discussion of concepts and principles in the draft IFRS. The important section on '*Concepts and Pervasive Principles*' is written in an accessible style, with an emphasis on the importance of costs vs. benefits. This provides a firm basis for appropriate application of the detailed requirements that follow.

14. We strongly support the emphasis on *substance over form* in paragraph 2.6 and the clear and succinct exposition of the principle. We also commend the clear discussion of the concept of *prudence* in paragraph 2.7, and the greater focus on stewardship than is found elsewhere in the Board's literature. Paragraph 2.1 states that in meeting their primary objective, the financial statements of 'SMEs' also show the results of management's stewardship of the entity's resources. Nonetheless, we believe that stewardship is more important than is implied in the draft standard and that it should therefore be explained and given greater emphasis.

The Simplification Process – An Assessment

15. In general, we consider that the Board has struck an appropriate balance between simplification and retaining adequate guidance and disclosures to meet the needs of users of 'NPAE' financial statements. This is a considerable achievement. Overall, the volume of material in the full standards book has been reduced substantially, achieved by cutting out guidance not usually relevant to NPAEs whilst - crucially - not requiring a mandatory 'fallback' to full IFRS when transactions are encountered that are not dealt with in the 'SME' standard. In this connection we strongly support the deletion of paragraph 10.3 (c) of former staff drafts of the standard referring to the requirements and guidance in full IFRS and Interpretations dealing with similar and related issues.

16. However, the Board still needs to make some further significant improvements to the style and contents of the proposed standard. As discussed in our response to Question 1 below, these include changing the order of certain sections, putting the most commonly used principles and rules first, and rephrasing some of the words drawn directly from full IFRS to make them easier to understand.

17. Further simplification of some specific accounting requirements is also required, as discussed below in our responses to Questions 2 and 3, in particular:

- removing the measurement principles for equity-settled share-based payments;
- introducing an amortisation approach for goodwill and other intangibles without finite lives; and
- further simplifying the requirements for financial instruments.

Care should also be taken to avoid imposing any accounting treatments on companies applying the IFRS for SMEs that are more complex than those applicable in full IFRS.

Updating the Standard

18. As discussed below in our response to Question 11, we believe that the Board should every two years merely assess the need to update the standard, rather than updating it every two years as a matter of course.

RESPONSES TO SPECIFIC QUESTIONS

Question 1 – Stand-alone document

In deciding on the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and other events and conditions typically encountered by SMEs with about 50 employees. For such entities, the proposed IFRS is intended to be a stand-alone document, with minimal cross-references to full IFRSs.

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?

19. We agree that the standard should be a stand-alone document and furthermore that there should be *no* cross-references to IFRS. Cross-referencing would oblige the user of the IFRS for SMEs to keep up to date with developments in full IFRS and would introduce an element of instability into the IFRS for SMEs. As discussed above, we therefore recommend that the Board incorporates in the standard the additional guidance needed to create a comprehensive, fully stand-alone product. Where alternative accounting provisions are likely to be used rarely or relate to more complex optional treatments, a simplified version of the detailed material should be included in the standard for ease of use as an appendix within the relevant section of the document. It should be presented in such a way that it is clear to those preparing accounts for a business with less complex transactions that they need read no further (e.g. through boxing, shading, and inclusion at the end of the section). We also recommend rephrasing some of the words drawn directly from full IFRS to make them easier to understand for the likely users of the 'SME' standard.

20. After careful consideration, we conclude that this approach is a practical proposition without exception. It is recognised that this course of action - and the inclusion of additional options (discussed below in our response to Question 4) will add to the length of the standard, but we consider that this is a price worth well paying to attain a standalone document. We believe that a self-sufficient document is of substantially greater value to the user than a document which requires knowledge of or reference to other texts. We also believe that the length of the resultant standard could be significantly reduced by cutting out, on a chapter by chapter basis, guidance too complex for the requirements of most NPAEs.

Question 2 – Recognition and measurement simplifications that the Board adopted

The draft IFRS for SMEs was developed by:

(a) extracting the fundamental concepts from the IASB Framework and the principles and related mandatory guidance from full IFRSs (including Interpretations), and

(b) considering the modifications that are appropriate in the light of users' needs and cost-benefit considerations.

Paragraphs BC70–BC93 of the Basis for Conclusions describe the simplifications of recognition and measurement principles contained in full IFRSs that have been made in the proposed IFRS for SMEs and explain the Board's reasoning. Are there other recognition or 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; and
(c) how that problem might be solved.

Financial Instruments

21. The Board has made an impressive effort to simplify IFRS accounting for financial assets and liabilities. But more needs to be done before this section could be understood and applied by NPAEs, even those of some size and sophistication. In particular, we do not as a matter of principle agree with the formulation adopted in paragraph 11.8, i.e. all financial instruments are measured at fair value subject to exceptions. We would prefer the default option to be cost, with fair value only used when it is 'readily determinable without undue cost or effort' (as in the case of biological assets in Section 35.1 of the draft standard).

22. The outline treatment of financial instruments we propose is included in the standard is as follows:

- Loans, receivables and financial instruments such as those described in paragraph 11.10 should be measured at cost or amortised cost less impairment, supplemented by the disclosures on risk set out in paragraph 11.52; and

- Other financial instruments, such as those described in paragraph 11.11, should be measured at fair value if this can be readily determined without undue cost or effort. Otherwise, they should be measured at cost or amortised cost less impairment.

23. The outline treatment set out above would eliminate the need to designate instruments, including most of the everyday ones, that are to be measured at amortised cost, and hence the detailed and rather impenetrable material at paragraphs 11.9 and 11.10 could be excluded. Nonetheless, we believe that the proposals in relation to financial instruments would still be too complex overall for NPAEs and that the guidance found in Section 11 is not sufficiently clear. In particular, and regardless of whether cost or fair value is the default option, Appendix B, which purports to offer guidance on fair value considerations, is too difficult for its target readership, and needs to be simplified. Similarly, the concept of reliable measurement pervades Section 11, but is not explained sufficiently to make it operational in practice.

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

Paragraphs BC94–BC107 identify some recognition and measurement simplifications that the Board considered but decided not to adopt, for the reasons noted. Should the Board reconsider any of those and, if so, why?

Amortisation of Intangibles

24. We favour the introduction on an optional basis of a rebuttable presumption that intangibles, including goodwill, have a useful life of not more than 20 years and should be amortised over that period, with recoverable amounts tested only if there are indications of impairment. Notwithstanding the arguments in BC80, we consider that most NPAEs will find this approach substantially easier to understand and operate, with little reduction in the value of the financial statements to NPAE users.

Share Based Payment

25. Although paragraph BC91 implies that intrinsic values will be used widely because of the challenges involved in measuring fair value reliably, IFRS 2 refers in this context to ‘rare cases’, and we believe that a significant number of SMEs would be required by the proposals to adopt IFRS 2 *Share-based Payment*. In such cases, in general the cost involved will substantially outweigh any putative benefits to users of the financial statements.

26. We thus strongly recommend that equity-settled share-based payments should be dealt with by disclosure only, and cash-settled share-based payments - which we would not expect to be common for unlisted companies - should be dealt with by reference to intrinsic values. We are confident that this will not undermine the credibility or usefulness of NPAE financial reporting.

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

The draft IFRS for SMEs proposes that accounting policy options available under full IFRSs should generally also be available to SMEs. As explained more fully in paragraphs BC108–BC115 of the Basis for Conclusions, the Board concluded that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities following full IFRSs. At the same time, the Board recognised that most SMEs are likely to prefer the simpler option in the proposed IFRS for SMEs. Therefore, the Board concluded that in six circumstances in which full IFRSs allow accounting policy options, the IFRS for SMEs should include only the simpler option, and the other (more complex) option(s) should be available to SMEs by cross-reference to the full IFRSs.

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?

27. We believe that with a very small number of exceptions, the recognition and measurement options available under full IFRS should be included in the IFRS for SMEs. Retention in the IFRS for SMEs of most IFRS recognition and measurement options will allow for maximum flexibility and ensure that the IFRS for SMEs can be applied by the subsidiaries of listed IFRS reporters. In our view these considerations outweigh the value of the simplicity of prescribing a single required treatment. We recognise that this approach may result in a reduction in comparability, but do not

see this as a major concern in the context of private company financial reporting. We refer to the detailed changes required to the draft standard to implement this approach in comments below on each of its sections. We believe there are just two valid exceptions to approach of including all recognition and measurement options available under full IFRS. These are:

- the 'corridor approach' available under IAS 19, which we consider to be fundamentally flawed; and
- the fair value measurement of equity-settled share-based payments available under IFRS 2, given that it would be onerous for an NPAE to arrive at a fair value and the benefits of the information limited by the lack of reliability of the valuation.

28. Where options available under full IFRS are included these should, however, be expressed in a simplified way, designed to make them as accessible as possible to NPAE preparers. We suggest that the detail of the simpler option be given first and the details of more complex options relegated to the end of each chapter.

29. We agree with the general approach taken in the exposure draft of not recommending which option is the most suitable for an entity, given that full IFRS makes no recommendation on selection.

Question 5 – Borrowing costs

IAS 23 Borrowing Costs currently allows entities to choose either the expense model or the capitalisation model to account for all of their borrowing costs. In May 2006 the IASB published an Exposure Draft proposing to amend IAS 23 to prohibit the expense model and to require the capitalisation model. Section 24 Borrowing Costs of the draft IFRS for SMEs proposes to allow SMEs to choose either the expense model or the capitalisation model.

Do you agree or disagree with the proposal to allow SMEs to choose either the expense model or the capitalisation model for borrowing costs, and why?

30. We agree that there should be an option to expense interest, a simpler option likely to be attractive to many NPAEs, or to capitalise interest, thus providing flexibility for entities wishing to apply the measurement requirements of full IFRS.

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

Some topics addressed in full IFRSs are omitted from the draft IFRS for SMEs because the Board believes that typical SMEs are not likely to encounter such transactions or conditions. These are discussed in paragraphs BC57–BC65 of the Basis for Conclusions. By a cross-reference, the draft standard requires SMEs that have such transactions to follow the relevant full IFRS.

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

31. No additional topics should be omitted, with - as discussed in the Appendix to this response - the exception of interim financial reporting. We have explained above that we do not support replacement of topics by cross-references. The more cross-references, the less useful the standard.

Question 7 – General referral to full IFRSs

As noted in Question 1, the IFRS for SMEs is intended to be a stand-alone document for typical SMEs. It contains cross-references to particular full IFRSs in specific circumstances, including the accounting policy options referred to in Question 4 and the omitted topics referred to in Question 6. For other transactions, events or conditions not specifically addressed in the IFRS for SMEs, paragraphs 10.2–10.4 propose requirements for how the management of SMEs should decide on the appropriate accounting. Under those paragraphs, it is not mandatory for SMEs to look to full IFRSs for guidance.

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?

32. We agree with the non-mandatory fallback to full IFRS outlined in paragraph 10.4, although we think some brief reference to IFRIC interpretations is required here. However, experience in the UK strongly suggests that the non-mandatory nature of the reference to consulting the full standards book should be made absolutely clear - which it is not at present - to prevent uncertainty arising over a perceived need to refer back to full IFRS on a regular basis in order to identify and adhere to 'best practice', perhaps to meet the expectations of regulators. The paragraph could, for example, start as follows:

33. 'Management are not required to look further for guidance than the sources referred to in paragraph 10.3. However, in making the judgement described in paragraph 10.2, management may, at their discretion, also consider…

34. In our view the guidance in 10.2-10.4 should be sufficient without explicit cross-referencing to full IFRS.

Question 8 – Adequacy of guidance

The draft IFRS for SMEs is accompanied by some implementation guidance, most notably a complete set of illustrative financial statements and a disclosure checklist. A sizeable amount of guidance that is in full IFRSs is not included. Accordingly, additional guidance especially tailored to the needs of SMEs applying the proposed IFRS may be required.

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

35. We welcome the development of illustrative financial statements and a disclosure checklist, and in general consider that the implementation guidance is adequate.

Question 9 – Adequacy of disclosures

Each section of the draft IFRS for SMEs includes disclosure requirements. Those requirements are summarised in the disclosure checklist that is part of the draft implementation guidance Illustrative Financial Statements and Disclosure Checklist.

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?

36. In general, we consider the level of disclosure requirements to be appropriate. We have pointed out in the Appendix to this response a number of instances where improvements could be made, in particular regarding disclosure requirements in sections 18 and 19 that we regard as unnecessarily onerous.

Question 10 – Transition guidance

Section 38 Transition to the IFRS for SMEs provides transition guidance for SMEs that move (a) from national GAAP to the IFRS for SMEs and (b) from full IFRSs to the IFRS for SMEs.

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

37. We are generally content with the provisions regarding transition to the IFRS for SMEs, but have included some suggestions for improvement in the Appendix to this response.

Question 11 – Maintenance of the IFRS for SMEs

The Board expects to publish an omnibus exposure draft of proposed amendments to the IFRS for SMEs approximately every other year. In developing such exposure drafts, the Board expects to consider new and amended IFRSs that have been adopted in the previous two years as well as specific issues that have been brought to its attention regarding possible amendments to the IFRS for SMEs.
On occasion, the Board may identify a matter for which amendment of the IFRS for SMEs may need to be considered earlier than in the normal two-year cycle.

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

38. As discussed above, we agree a two year interval is appropriate to review the IFRS for SMEs but disagree that such a review should necessarily giver rise to routine changes to the standard following changes to full IFRS. A key objective of the IFRS for SMEs is to provide a “simplified, self-contained set of standards”. Minimal change would provide stability and make it easier for the preparers to keep up to date and apply the standard. As full IFRS becomes increasingly complex, changes to keep the IFRS for SMEs in line with full IFRS should be resisted unless there is a robust case for amending the ‘SME’ standard. The test of cost vs. benefit should be applied rigorously to any proposed change.

39. Naturally enough, the current draft takes no account of ongoing work on the revision of the conceptual framework and a number of key standards. This programme of work implies a series of substantial changes to the IFRS for SMEs, a process which will require careful consideration and management.

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APPENDIX
ADDITIONAL DETAILED COMMENTS PER SECTION

Preface

1. Paragraphs P5 and P6 explain the purpose and nature of IFRS and the conceptual framework. We suggest that reference is made here to the place of IFRIC interpretations in IFRS reporting.

2. We welcome the clear explanation in paragraphs P7 and P8 of what constitutes 'general purpose financial statements'.

Section 1 - Scope

3. We broadly agree with the approach adopted by the Board in defining the scope of the proposed standard, including the restriction of its scope to non-publicly accountable entities. However, as discussed above, we do not believe that the IFRS for SMEs will be appropriate for very small entities ('micro entities') which make up a substantial sub-set of NPAEs. We also have a number of other concerns regarding this section, as explained below.

4. The proposed scope of the standard excludes entities that 'hold assets in a fiduciary capacity for a broad group of outsiders' (paragraph 1.2b). Paragraph BC36 indicates that this provision is designed to exclude financial institutions, and we support this exclusion. However, we are not convinced that the term 'fiduciary capacity' is sufficiently precise and well-understood, particularly across different jurisdictions. For example, we question whether insurance companies act in a fiduciary capacity by standing ready 'to hold and manage financial resources entrusted to them': arguably they receive a fee in return for assuming liability for a risk. We suggest, therefore, that either the term 'fiduciary capacity' is clearly defined, or perhaps dropped altogether in favour of a fully explained reference to financial institutions.

5. Whilst we understand the concerns that underlie the Board's attempt in paragraph 1.3 to prescribe which entities can assert conformity with the standard, we do not agree that this is appropriate, or desirable. Notions of 'public accountability' will vary from jurisdiction to jurisdiction, and it seems illogical to seek to deny a reporting entity the right to assert that its financial statements are 'in conformity with the IFRS for SMEs' if indeed that it is the case. We thus suggest that the Board deletes paragraph 1.3. At the same time the Board might add a sub-paragraph in paragraph 1.2 to make it clear that jurisdictions may apply their own definitions of what is a publicly accountable entity.

6. Given the debate in the context of the conceptual framework project over the scope and meaning of the term 'creditors', it might be helpful if the Board states expressly that 'creditors' in paragraph 1.1(b) encompasses trade creditors, as well as lenders.

Section 2 - Concepts and Pervasive Principles

7. As mentioned above, we welcome inclusion in the draft standard of the clear and concise discussion of concepts and principles in the context of NPAEs. We set out below some detailed comments on this section.

8. Paragraph 2.38 states that 'Profit or loss is the arithmetical difference between income and expenses.' However, this statement should be modified to reflect the fact that income and expense can include items that are taken directly to equity.

9. Paragraph 2.39 states that the standard 'does not allow the recognition of items in the balance sheet that do not meet the definition of assets or of liabilities'. However, we question whether this statement is true in the light of the approach taken to the treatment of government grants in Section 23. This should be reconsidered.

10. Paragraph 2.41 is potentially misleading in stating that 'an entity generally measures financial assets and financial liabilities at fair value'. This is not the case in practice, especially in relation to liabilities. We suggest that it would be more helpful – and true to reality - to state here that after initial recognition financial assets and liabilities are measured at either at cost/amortised cost or at fair value, with a cross reference to Section 11 'Financial assets and liabilities'.

11. We also suggest that the formulation in paragraph 2.42 is misleading. 'Property plant and equipment' is measured either at depreciated cost less impairment or at fair value - not at 'the lower of depreciated cost and fair value less costs to sell'.

Section 3 - Financial Statement Presentation

12. We are generally content with this section, although we have set out below a number of detailed comments.

13. We suggest that the structure of this section would be more logical if paragraphs 3.15-3.19, 'Complete set of financial statements', were moved to the beginning of the section.

14. We are concerned that the references to 'fair presentation' in this section are unclear. The 'extremely rare circumstances' in which non-compliance is justified are not described or exemplified. We suggest that paragraph 3.1(a) should be amended to encompass the idea that compliance will 'normally' or 'in virtually all circumstances' (as in paragraph 15 of IAS 1) result in a fair presentation. Further material could usefully be imported from IAS 1.15 to clarify the additional criteria for a fair presentation.

15. We also do not find paragraph 3.1(b) helpful, given that entities with public accountability are already scoped out of the draft standard. Its purpose seems to be to add a gloss to paragraph 1.3, which we believe should be deleted. We suggest that this sub-paragraph, too, be deleted.

16. Paragraphs 3.3 - 3.6 deal with the 'extremely rare circumstances' in which an entity departs from the standard because compliance would be misleading. We suggest that locating this material near the start of the section accords it undue prominence, and that these paragraphs should instead appear towards the end of the section.

17. We note that the requirement in paragraph 3.8 to present a complete set of accounts 'at least annually' is inconsistent with the preparation of financial statements for a period longer than one year. This statement should be amended accordingly.

18. The import of paragraph 3.17 is not clear, given that the requirement for comparative information is already stated in paragraph 3.12. We suggest that it should be deleted.

Section 4 - Balance Sheet

19. We suggest that a more logical location for paragraphs 4.13 and 4.14 would be in Section 21 'Equity'.

20. We commend the useful guidance given in paragraphs 4.14 for entities without a share capital, which should be retained.

Section 5 - Income Statement

21. Paragraph 5.6 prohibits the inclusion of 'extraordinary items' in the profit and loss account, but this only really makes sense to someone with knowledge of the debates by standard setters over this concept. We suggest that this paragraph be deleted.

22. We strongly suggest that the Board deletes, on cost vs. benefit grounds, the requirement in paragraph 5.7(a) for disclosures of write-downs of inventories, and reversals. In many smaller businesses this information is unlikely, in practice, to be readily available.

Section 6 - Statement of Changes in Equity and Statement of Income and Retained Earnings

23. We are content with this section, although we would draw attention to our comments below regarding the presentation of actuarial gains and losses relating to pension obligations.

Section 7 - Cash Flow Statement

24. In principle we support exclusion of requirements relating to cash flow statements in standards designed for smaller companies. However as, in our view, this standard is unlikely to be used by most small companies, we support the inclusion of this section and have no comments on the detailed requirements.

Section 8 - Notes to the Financial Statements

25. We are not convinced that disclosure of the information about judgements by management required by paragraph 8.6 is necessary in the case of NPAEs, although we agree that there may be some benefit in the case of the larger entities to which the draft standard is most appropriate. If paragraph 8.6 is retained, we suggest that explanatory material from IAS 1 should also be included.

Section 9 - Consolidated and Separate Financial Statements

26. Paragraph 9.21 introduces the idea of 'combined financial statements', which does not feature elsewhere in IFRS literature. We support this innovation in principle, but have some concerns over the introduction of a significant change of this nature without full due process. We would in any case need to see a fuller explanation in the Basis of Conclusions before we could be confident that it will work satisfactorily in practice. We can see practical difficulties arising in respect of, for example, inter-company items and equity, before many combined financial statements could be described as compliant with the IFRS for SMEs.

Section 10 - Accounting Policies, Estimates and Errors

27. We note that paragraph 10.9(b) is, in effect, a cross-reference to full IFRS, which the Board would need to delete if the standard were made fully stand-alone, in line with our recommendations.

Section 11 - Financial Assets and Liabilities

28. We have explained above in our response to Question 2 what more needs to be done before this section could be understood and applied by NPAEs, even those of some size and sophistication. A number of other concerns and observations are set out below.

29. The Board has made a determined and generally successful attempt to simplify the provisions for hedge accounting (paragraph 11.29 et seq). We recognise that the requirements for designation and documentation are relatively undemanding - and may, for example, lead to designation at a late stage - but overall we consider that the simplified requirements are pitched at an appropriate level for the few NPAEs that wish to account for hedging activities.

30. The draft standard does not include a definition of 'cost' or 'amortised cost', and we consider that this should be remedied. It also fails to address the split between debt and equity. This seems to us to be a serious shortcoming. We strongly suggest that simplified guidance and definitions are added to the standard.

31. It would also be helpful if the draft standard made a brief, specific reference to derivatives, to avoid any uncertainty over their accounting treatment. Paragraph 11.2(h), for example, could read 'Derivatives such as options … etc'.. We recognise that it would be necessary, as a corollary, to include a definition of derivatives in the glossary. In addition, we believe that a brief reference to embedded derivatives – and more particularly the lack of any requirement to separate them from the host instrument - should be added to the Basis for Conclusions to avoid uncertainty for users of the standard who are also familiar with full IFRS.

32. Finally, as we wish to see a fully standalone standard, we do not support the inclusion of reference to the requirements of IAS 39 *Financial Instruments: Recognition and Measurement* as an alternative treatment to whatever simplified approach is provided in the eventual IFRS for SMEs. However, as it is important not to discourage use of the IFRS for SMEs by subsidiaries that need to provide IFRS-compliant numbers for consolidation purposes, we advocate inclusion as an appendix to the IFRS an alternative set of requirements to Section 11, compliant with all of the key measurement and recognition requirements of IAS 39, but simplified as far as possible and excluding many of the related disclosure provisions.

Section 12 - Inventories

33. As explained above, we suggest that the requirements to disclose impairment charge as an expense (paragraph 12.21d) and any reversal of impairments (paragraph 12.21e) are unnecessary and should be deleted.

Section 13 - Investments in Associates

34. We support the proposal to allow NPAEs a choice between the cost, equity and fair value models. However, the relevant requirements of the equity method should be

summarised in the standard to avoid the need to refer to IAS 28 *Investments in Associates*.

35. We suggest that the requirement to disclose the share of discontinued operations of associates in paragraph 13.8 is unnecessary and should be deleted.

Section 14 - Investments in Joint Ventures

36. We support the proposal to allow a choice between the cost, equity, proportional consolidation and fair value models. However, the relevant sections of IAS 28 and IAS 31 *Investments in Joint Ventures* should be reproduced in the standard to avoid the need to cross-refer.

Section 15 - Investment Property

37. We support the proposal to allow a choice between the cost and fair value models. The relevant requirements of IAS 40 regarding the fair value model should be included in the standard in a simplified form.

Section 16 - Property, Plant and Equipment

38. We support the proposal to require initial recognition of property, plant and equipment at cost, with a choice thereafter between the cost and revaluation models. The revaluation requirements of IAS 16 *Property, Plant and Equipment* should be included in the standard, possibly as an appendix to this section.

39. We consider that this section could be usefully restructured, advancing important principles such as that in paragraph 16.6, and deferring more detailed material such as that found in paragraphs 16.2 and 16.4.

Section 17 - Intangible Assets other than Goodwill

40. We support the proposals in the draft standard, except, as discussed above, we favour the introduction on an optional basis of a rebuttable presumption that intangibles, including goodwill, have a useful life of no more than 20 years and should be amortised over that period.

41. With regard to the capitalisation and revaluation options, we suggest that the relevant requirements of IAS 38 *Intangible Assets* should be included in the standard.

42. It would be helpful if the wording in paragraphs 17.7-17.13 was aligned with the equivalent wording in Section 16.

43. Finally, the material in paragraph 17.24 could be usefully augmented with material from IAS 38 dealing with, for example, finite and indefinite useful lives.

Section 18 - Business Combinations and Goodwill

44. We support in principle the proposals in the draft standard, subject to the detailed matters outlined below and our comments regarding the amortisation of goodwill and other intangibles.

45. We observe that the use of the phrase "purchase of all the net assets of another entity" (paragraph 18.2) may be confusing, as such a transaction, in itself, does not constitute a business combination under IFRS 3.

46. Although we are concerned that the test of reliable measurement might in practice be used as a pretext for not separating intangibles from goodwill, on balance we are content for this provision to remain in the standard (paragraph 18.14c).

47. This section of the standard would be enhanced significantly by the inclusion of clear guidance in the following areas:

- the acquisition of entities or groups of assets that are not businesses (such as the material in paragraph 4 of IFRS 3);
- common control; and
- reverse acquisitions and step acquisitions.

48. The following disclosure requirements are onerous in the context of NPAEs and should be deleted from the standard:

- the requirement to disclose details of any operations the entity has decided to dispose of as a result of a business combination effected during the reporting period (paragraph 18.23e);
- the requirement to disclose factors that contributed to goodwill (paragraph 18.23h); and
- the requirement for detailed disclosures in respect of post balance sheet acquisitions (paragraph 18.24).

Section 19 - Leases

49. We do not agree that assets held under finance leases should be recognised at fair value by the lessee (paragraph 19.8). Such leased assets should be recognised at the lower of the present value of the minimum lease payments and fair value. Given that the minimum lease payments need to be calculated anyway, this will simplify the standard.

50. We support the requirement in paragraph 19.15 to apply the requirements of IAS 17 to lessors accounting for finance leases. However, paragraphs 36 - 46 and 47 of IAS 17, appropriately simplified, should be included in the standard.

51. We note that there is no reference to separating-out land, which we assume is intentional. It would be helpful if the Basis for Conclusions were to set out the reasons for this.

52. The following disclosure requirements are onerous and should be deleted from the standard:

- future minimum lease payments by year (finance leases, paragraph 19.12b);
- contingent rents recognised as an expense in respect of finance leases, (paragraph 19.12c); and
- the total of future minimum lease payments under non-cancellable operating leases by year (paragraph 19.14a).

Section 20 - Provisions and Contingencies

53. We are generally content with the proposed provisions.

Section 21 - Equity

54. We are generally content with the proposed provisions. However, we can see a case for juxtaposing the section on equity with that on financial assets and financial liabilities (Section 11), given the close connection between the conceptual issues involved.

55. Paragraph 21.2(a) states that if equity instruments are issued before cash is provided in exchange, the amount receivable should be treated as an offset to equity. In our view, it would normally be treated as an asset. While we do not necessarily object to the proposed treatment in context, it would be helpful if the Basis for Conclusions addressed this issue.

Section 22 - Revenue

56. Generally this section is sound. However, it would benefit from restructuring. For example, the inclusion close to the beginning of the section of paragraphs 22.5 and 22.6 on deferred payment detracts from the material of more general relevance that follows.

Section 23 - Government Grants

57. We support the approach set out in the draft standard for accounting for government grants. However, in order to create a standalone standard, the relevant requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* should be incorporated into the standard.

Section 24 - Borrowing Costs

58. We strongly support the approach in the draft standard, which provides NPAEs with the option to expense or capitalise borrowing costs.

Section 25 - Share-based Payment

59. We have explained above in our response to Question 3 that the approach set out in the draft standard is too complex for NPAEs. If the Board accepts our recommendations in this area, we suggest that the material on cash-settled share based payments be relocated in the section of the draft standard that deals with non-financial liabilities.

60. We also note that, unlike IFRS 2.3, no reference is made to shares transferred by shareholders to parties that have supplied goods or services to the company. Such transactions may be more common in NPAEs than listed companies, and thus the distinction is surprising if the Board intend to follow their proposed approach.

Section 26 - Impairment of Non-financial Assets

61. We support the approach proposed in the draft standard: that is, requiring impairment testing for goodwill and intangibles only if there is an indication that an impairment has occurred. However, we believe it is important to reinstate value-in-use as a measure, since this will often be more relevant than a disposal valuation. Without reference to value-in-use there is a risk of recognising too great an impairment loss, or a loss that is not relevant in the context of the business.

62. It would be helpful to relocate paragraph 26.11, which usefully explains what an impairment is, at the beginning of the section (suitably modified to encompass value-in-use).

63. We also recommend that the Board provides a brief description of the process involved in carrying out an impairment review.

Section 27 - Employee Benefits

64. We are broadly content with the general recognition principle for all employee benefits, as set out in paragraph 27.3, including the exclusion of the option to use the 'corridor' approach, which we regard as conceptually flawed. However, we have concerns about the proposed treatment of actuarial gains and losses.

65. The draft standard requires all actuarial gains and losses to be recognised immediately in profit and loss. This approach has merit in relation to small companies, but not the larger entities likely to report under the IFRS for SMEs. Given that the corridor approach is not allowed, there is the prospect of considerable volatility. In our view, companies applying the IFRS for SMEs should have the option to present these amounts in a Statement of Recognised Income and Expense (SORIE), presented with the same prominence as the income statement.

66. We note that the disclosures required in paragraph 27.38 do not fully reflect the fact that the draft standard at present requires actuarial gains to be recognised in profit and loss.

67. We also note that the exceptions listed in paragraph 27.21 (a) and (b) should also cover amounts included in development costs.

68. The Board might wish to reconsider the need for some guidance on group plans and a reference to constructive obligations.

Section 28 - Income Taxes

69. We broadly support the approach to accounting for current taxes. However, while we applaud the Board's attempt to simplify accounting for deferred taxes by basing it on timing differences, we find the analysis and explanations in Section 28 in need of much further simplification and restructuring, with clear principles and explanations provided at the outset. For example, a rule central to the accounting is stated in paragraph 28.15, in the middle of the section. As it stands, this section is likely to be very confusing for most of its intended audience. Once redrafted, we strongly suggest that the clarity of this section is tested with a number of potential users of the standard with no background in IFRS.

70. We find paragraph 28.17 incomprehensible, and suggest it be expressed differently, or deleted. In addition, the different deferred tax rules depending on whether an asset or liability arose from a business combination are a source of confusion. Most assets and liabilities do not arise in NPAEs in the context of a business combination, and therefore we suggest that the rules for those assets and liabilities are stated first, with the business combination rules afterwards.

Section 29 - Financial Reporting in Hyperinflationary Economies

71. We note that the simplified, purely numerical approach to whether there is a hyperinflationary economy (i.e. 100% in 3 years) may give a different answer to the

more judgemental approach in IAS 29, which could cause confusion. Nonetheless, we accept the rationale for adopting this approach, but (as we wish to see a fully standalone standard) recommend inclusion as an appendix to this section an alternative set of requirements, broadly compliant with IAS 29.

Section 30 - Foreign Currency Translation

72. We have no substantive comments on this section. It would however be helpful if a definition of a foreign operation were included in the glossary.

Section 31 - Segment Reporting

73. We agree that NPAEs should not be required to present information about operating segments. However, the second and third sentences of paragraph 31.1 are needlessly restrictive and damaging to good financial reporting. Paragraph 3.1 requires additional information if it is necessary for a fair presentation and we do not believe that the Board should be discouraging additional segmental disclosure.

74. We suggest that the second and third sentences of paragraph 31.1 should be deleted, and replaced with a comment that segmental information may be presented but must be accompanied by adequate disclosure regarding the basis of preparation. We also suggest that this approach is adopted in relation to the voluntary disclosure of Earnings Per Share information, and that the two sections are combined under in a new section on 'additional information'.

Section 32 - Events after the End of the Reporting Period

75. We are broadly content with this section, although we note that the term 'equity instruments' used in paragraph 32.7 is not defined anywhere in the IFRS for SMEs.

Section 33 - Related Party Disclosures

76. We strongly suggest that on cost: benefit grounds the Board provides an exemption in this section for intra-group transactions where 100 per cent of the voting rights in the subsidiary or subsidiaries are owned within the group.

77. The following additional material would be helpful for users of the standard:

- a definition of a close member of the family; and
- an explanation of why disclosure of related parties is important, to augment the principles of disclosure.

Section 34 - Earnings per Share

78. Please see our comments above on Section 31.

Section 35 - Specialised Industries

79. The default treatment for agricultural businesses applying the standard should be depreciated cost, not fair value. Notwithstanding the comments in the Basis for Conclusions, the fair value model is not generally appropriate for small agricultural businesses. There are practical problems with valuation, unrepresentative markets (for example, when a product is for the most part produced to contract) and disproportionate costs. Small agricultural businesses are rarely managed on a fair

value basis, and overall, the costs of the fair value model far outweigh the benefits (if any) to users.

80. We note that the proposed standard circumvents this problem by allowing the depreciated cost model to be used where 'fair value is not readily determinable without undue cost or effort', which will generally be the case. However, this does not justify mandating an inappropriate model in the first place. We do however recognise the potential usefulness of the concept of a value being 'not readily determinable without due cost and effort' and would strongly encourage the Board to consider whether the formulation could be used more widely in the standard.

81. We suggest that the Board clarifies in paragraph 35.3 the position of companies that provide insurance products, but are not insurance companies.

Section 36 - Discontinued Operations and Assets Held for Sale

82. We support the proposals regarding discontinued operations; in our experience disclosures in this area are of considerable interest to the users of the financial statements of all companies, whether listed or not.

83. We are less convinced regarding the benefits of the requirements relating to non-current assets held for sale, and would encourage the Board to consider further simplification in this area.

Section 37 - Interim Financial Reporting

84. We suggest that it would be more logical if the IFRS deals only with annual financial statements. This section should, accordingly, be deleted.

Section 38 - Transition to the *IFRS for SMEs*

85. We are generally content with the provisions regarding transition to the IFRS for SMEs, but we suggest the Board explores the merit of providing a more general exemption from retrospective application on the grounds of impracticability.

86. We commend the sympathetic approach to deferred income taxes in paragraph 38.8(f), but suggest that some explanation be given of the approach to be taken by a first time adopter making use of this concession. For example, is the non-recognition of such balances effective at transition date or balance sheet date? And is the subsequent accounting similar to that following an initial recognition exemption?

87. We also suggest that the Board defines the 'date of transition', referred to in, for example, paragraph 38.5.

Glossary

88. The definition of current tax should also allow that it might be in respect of previous periods.

89. The definition of related parties refers to IAS 28 and IAS 31. These references should be avoided to keep the document as standalone, by converting them to references to sections 13 and 14.