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Our ref: ICAEW Rep 52/11

Your ref:

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Dear Michelle

THE FUTURE OF FINANCIAL REPORTING IN THE UK AND ROI

ICAEW is pleased to respond to your request for comments on *The Future Of Financial Reporting In The UK And ROI*.

Please contact me or John Boulton (john.boulton@icaew.com) should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

THE FUTURE OF FINANCIAL REPORTING IN THE UK AND ROI

Memorandum of comment submitted in May 2011 by ICAEW, in response to ASB consultation paper *The Future of Financial Reporting in the UK and ROI* published in October 2010.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the Exposure Draft *The Future of Financial Reporting in the UK and ROI*, published in October 2010 by the Accounting Standards Board (the Board).

WHO WE ARE

2. ICAEW 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, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 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. We ensure that these skills are constantly developed, recognised and valued.

MAJOR POINTS

This is the time for a fundamental change

4. We agree that there is a need for fundamental change to the regime for UK financial reporting, and that it is time to draw to a close the prolonged period of reflection on this issue. Current UK GAAP is neither a comprehensive and coherent accounting framework, and nor does it sit comfortably alongside the parallel IFRS accounting regime. Nevertheless, there are some shortcomings in the present proposals, which we explore below.
5. In preparing these comments, our overriding concern is the quality of financial reporting in the public interest, subject to practicality and cost/benefit considerations. We have consulted very widely with our members, including those in small firms, and with groups representing various types and size of business and the not-for-profit sector. The extensive feedback we have received has informed our responses to the Board's proposals. The views expressed in this letter in some respects develop and update views expressed in response to previous consultations on this topic.

The transition period should be reconsidered

6. While we believe that the Board should move as quickly as possible to clarify the new regime for the UK, we are concerned that the proposed mandatory transition date of July 2013 may not allow adequate time to prepare for the change. The training, education and systems challenges should not be under-estimated. There is no reason why this consideration should cause any delay in issuing the new standard, and early adoption could be permitted, but we feel that an extension of the transition date to say 2015 might be welcomed by many. This may be a particular issue for those sectors where SORPs will need to be revised, and likely to be an acute problem for public-benefit entities for whom the new regime will not become fully evident until some time after the publication of the FRSME. A smooth and well-understood transition should be a key priority when the Board determines the timetable for change. We intend to do all we can to smooth the transition for our members and others affected by the change. The Board should plan to do the same.

The Board should consult immediately on the future of the FRSSE

7. During our outreach work, many of those we consulted with, particularly smaller practitioners closely engaged with the debate, expressed concern at the complexity of the proposed three-tier framework and strong support for wider use of the FRSME. We have therefore deliberated at some length the possibility of moving swiftly to a two-tier regime, as opposed to retaining the FRSSE for what may prove to be a substantial period. In our response to the Board's earlier discussion paper we favoured retention of the FRSSE on the pragmatic grounds of easing transition. However, now that we have had the opportunity to scrutinise the contents of the proposed FRSME, on balance, and subject to the important caveats below, we consider it preferable not to delay the replacement of the FRSSE, thereby allowing a common set of principles based on IFRS to be established at an early date for all reporting entities. Nevertheless, we believe that it will be necessary to add additional exemptions for small entities to the FRSME before it is suitable for that sector, for example, from the requirement to present a cash flow statement, and perhaps from elements of the business combinations requirements, and would expect this matter to be explored fully in any consultation.
8. There are of course some attractions to maintaining the FRSSE, especially for those who exclusively use that standard at present, and we are very aware that a significant number of our members are unconvinced at this stage about the merits of a two tier solution. Indeed, we recognise that the current consultation paper does not address this fundamental issue and that the Board will wish to understand fully the views of its constituents, especially those from public benefit and private sector SMEs who may not have engaged in the current debate on the understanding that the future of the FRSSE was excluded from its scope. We thus urge the Board to consult extensively and without delay with constituents specifically on this topic, and we stand ready to assist the Board in so doing. If the results of this consultation indicate broad support for a two tier solution, the Board should then move rapidly to put in place a single UK regime for entities without public accountability. We acknowledge that proposals are currently before the EU Council to reduce the accounting requirements of the directives for some 'micro' entities. The Board should continue to closely monitor developments, but our preference would be for the Board not to delay action on UK GAAP while waiting for possible progress on this issue in Brussels unless there is judged to be a real prospect that such companies may face two costly changes to their accounting in quick succession.
9. One of the main benefits that would result from moving directly to a two-tier regime would be a reduction in complexity. Conceptually, we believe that a single set of principles should underpin the accounting for all entities and we applaud the steps the Board has taken toward achieving this goal by proposing to shift UK GAAP onto an IFRS-based platform. But retention of the FRSSE would perpetuate the situation where two different platforms were in operation side by side. This creates practical difficulties in training and education, as for example most students will have been trained first in IFRS before encountering the entirely new platform represented by FRSSE. It is also confusing for users of the financial statements. This complication could also increase the risk of error, and could cause difficulties in systems, in comprehending the financial statements, and in transitioning between tiers. A key objective of the reform of UK GAAP should be greater simplicity: in the accounting framework, in the detailed requirements and in the resultant financial reporting. The current proposals go a long way toward achieving this goal, but retention of the third tier tends to militate against this.

Decision useful information provided by current UK GAAP should be retained

10. We agree with the underlying principle that the IFRS for SMEs should be the basis for FRSME, and understand the motivations behind the Board's decision to change the IFRS for SMEs as little as possible. But we do not agree that this always achieves the right outcome. The IFRS for SMEs, as it stands, may be seen as more suitable for adoption in jurisdictions without established accounting regimes, where simplicity may be of particular value; this is not the case with the UK, where GAAP has developed over a number of years, and its requirements are deeply embedded in users' decision making processes. Consequently, although the IASB's aim was to reduce complexity, the result for some UK entities will be the opposite. Accounting policies that may be acceptable under both current UK GAAP and EU-adopted IFRS may be unavailable to entities adopting the FRSME. This will, again, unnecessarily complicate training, systems and information requirements. Furthermore, given the standard setting experience that has been built up in the UK, we believe that the Board should take the lead in developing these improvements, which may then provide an influential blue-print to the IASB in updating the IFRS for SMEs.
11. In paragraphs 19 to 49 below we set out in detail those areas where we believe that the FRSME should be revised. One key improvement relates to topics where a particular treatment is allowed or required under EU-adopted IFRS, but prohibited under the proposed FRSME.

Further development is necessary of the public accountability definition

12. We agree with the Board's decision to use 'public accountability' as the tier 1 criterion, rather than one based upon size. We concur that stewardship over funds gathered from a broad group of outsiders does imply a higher level of accountability and agree that entities of this type are more likely to undertake the complex transactions that necessitate the use of full IFRS, notably in the case of financial instruments. However, we feel that the definition could be fine-tuned and urge the Board to undertake further work in this area.
13. In particular, appendix paragraph A2.9 lists a number of groups that 'for the avoidance of doubt' are deemed to be publicly accountable. The basis upon which these groups have been selected however is far from clear. For example, all stockbrokers are listed even though many will not hold any client assets, and all pension schemes are included even though some of the smallest schemes contain so few members that they may not qualify as a 'broad group of outsiders'. The appendix also lists entities that 'effect or carry out contracts of insurance', but it is unclear whether this would extend to insurance brokers. Entities must have clarity over which tier they fall into and therefore we suggest that some explanatory text be added to the appendix to indicate why those industry groups have been deemed to be publicly accountable and whether any exceptions would be permitted. In addition, it is not clear currently whether public benefit entities, which in other regards may consider themselves to be accountable to the public, are included. We feel that it may be desirable for the Board to clarify whether or not these types of entity are intended to be caught by the definition.
14. Furthermore, pension schemes are listed in appendix A2.9 and therefore all schemes would, by default, fall into tier 1. Whilst we agree that pension schemes ought to be considered to be 'publicly accountable' when their membership is sufficiently wide to constitute 'a broad group of outsiders', we have significant doubts, on cost/benefit grounds, about the appropriateness of extending EU-adopted IFRS to them. These concerns are explored further in paragraph 70 below.
15. At the lower end, it is clear that there are many entities which will be pulled into tier 1 for which the costs of applying full IFRS will be significantly in excess of the benefits obtained

by users. We agree with the exemption offered for prudentially regulated entities that satisfy all three of the Companies Act small company criteria, but this exemption seems to be too limited. The Board must give further consideration to those entities which meet all three of the Companies Act small company size criteria, but which are not prudentially regulated. For example, a wider definition for 'regulated' may be appropriate. There are many forms of regulation and 'prudential regulation' is only one. The Board may wish to consider holding further discussions with relevant regulatory bodies such as the Pensions Regulator to determine whether it would be appropriate to extend the exemption to the entities under their jurisdictions. The principle should be that the interests of the broad group of outsiders involved are appropriately monitored by an effective regulator.

We welcome the reduced disclosure regime for subsidiaries

16. One of the most popular elements of the Board's proposals has been the reduced disclosure regime for subsidiaries. Listed groups in the UK have, until now, largely opted not to move their subsidiary accounts onto EU-adopted IFRS due mainly to the onerous disclosures that this would necessitate. This has produced and perpetuated a situation where a series of consolidation adjustments have been required to move from local to group accounts. The proposed reduced disclosure regime would make it practicable for subsidiaries to apply EU-adopted IFRS in their own published accounts and we are therefore strongly in support of it.

A bridge should be provided between FRSME and Companies Act terminology

17. The headings and terminology mandated for use by incorporated entities in UK GAAP financial statements are set out in the Companies Act and currently differ from those used in IFRS. UK preparers would therefore have to use a different set of terminology to that which is contained within the FRSME or in EU-adopted IFRS. This is problematic, particularly as preparers must first refer to a different document to determine what this terminology actually is. It would be very useful to provide a bridge between the headings used in the FRSME and those required or suggested by the Companies Act. Therefore we would suggest that an introductory chapter explains the relationships between the various regulations and terminologies involved, and that a set of example primary statements be included to illustrate the terminology that would actually be used in Companies Act accounts. We welcome the steps taken in this direction by the Board's recent publication of a set of case studies. The Board may also like to consider consulting with BIS to determine whether it would be appropriate to request a dispensation in company law to allow FRSME terminology to be used in company financial statements.

The Board must give due attention to non-incorporated entities applying UK GAAP

18. We are very concerned that the proposals have been drafted solely from the perspective of companies. UK tax law requires 'GAAP' (UK GAAP or IFRS) to be applied by unincorporated entities too. In practice therefore UK GAAP is applied by a wide range of organisations; partnerships, sole traders, trusts, societies, unincorporated associations, and so on, and this ought to be acknowledged by the drafting. Some examples include the reference to the small entities exemption from tier 1, which is based upon meeting Companies Act 2006 conditions; and FRED 43 paragraphs 5, 6a and 10, which all refer to Companies Act 2006 requirements, and are therefore only relevant to incorporated entities.

SUGGESTED CHANGES TO FRSME

19. Conceptually we support the adoption of the IFRS for SMEs as a replacement for current UK GAAP. In general therefore we believe that modifications to the IFRS for SMEs should be kept to a minimum. However, we have identified a few specific areas where we believe that the operational advantages in the UK context outweigh the disadvantages of introducing dissimilarities between the UK FRSME and the IFRS for SMEs. These are set out in this section. The principle in our approach here is that there are certain treatments prohibited by the proposed FRSME that are both important to users' decision-making and permitted or required by EU-adopted IFRS and current UK GAAP. We propose changes under these conditions.
20. Over the medium-term, our hope and vision would be that future improvements made by the IASB to IFRS for SMEs, amendments to the Accounting Directives, and the process of more comprehensive familiarity in UK accounting with IFRS terminology and concepts, would significantly reduce these differences, perhaps even eliminating them. In all of this process, however, the UK Accounting Standards Board should remain clearly in charge of the GAAP to be applied in the UK.
21. We have also set out in paragraphs 50 to 64 some suggested additional guidance material, which we believe it would be useful to include within the FRSME document. And in the appendix to this letter we have set out some items which, while not meriting an adjustment in FRSME, we believe could usefully be brought to the attention of the IASB for consideration at the next revision of the IFRS for SMEs.

IAS 12 *Income Taxes* should be simplified for use in the FRSME

22. We agree with the Board's decision to replace section 29 *Income Tax* of the IFRS for SMEs. This chapter was based upon a set of IASB proposals that have subsequently been superseded and it is therefore likely that at the next revision, the IFRS for SMEs will be conformed with IAS 12 *Income Taxes*. In general we would not support the anticipation of potential future changes that may be made to the IFRS for SMEs. However, we believe that it is right to make an exception in this case as the current section 29 is clearly anachronistic.
23. Although we believe that chapter 29 of FRSME should be based upon IAS 12, we do not agree that it should replicate the full text of the standard as it currently does. Simplifications should be made such that it is closer in form to the seven pages of section 29 of the IFRS for SMEs than the 43 pages currently contained in FRSME. We do appreciate that in making these simplifications, the FRSME section may diverge slightly from the equivalent section in the IFRS for SMEs, even once that is similarly updated. However, this is unavoidable. We would not see this as being a difference in perpetuity and, at the next update of FRSME, the two could be brought into line.
24. We have considered whether a flow-through method of accounting for deferred tax might be appropriate, rather than one based on the temporary differences approach in IAS 12. Although being clearly simpler, there are several important deficiencies to the flow-through method. In addition to departing from current UK GAAP and IFRS expectations that deferred tax recognition is relevant, it would incorporate an element of cash accounting into an accruals based framework. Even if flow-through were to be considered for very small entities, it is not appropriate for the large private companies to which FRSME will apply. Also, for many smaller entities, a recognition of the implied position between entity and tax authorities is an important reminder. Those who advocate flow-through differ in their proposed application, for example as to whether short-term differences should be accounted for, and the extent of the disclosures to remedy the lack of recognition. We conclude that an appropriately abbreviated form of IAS 12 best meets the needs of the

FRSME at this stage and would not support the adoption of any alternative approaches that diverged from that standard.

Revaluation of property, plant or equipment should be permitted

25. FRSME, unlike full IFRS or current UK GAAP, does not contain an option to allow the revaluation of property, plant or equipment. Such a prohibition is likely to be problematic for those entities which have hitherto applied the revaluation option under UK GAAP. We understand from preparers that users do look to the balance sheet for an indication of a company's asset base and that for those entities with material property assets, the inability to reflect market values could distort this view. Therefore we believe an option should be inserted to allow revaluation of property, plant or equipment.
26. We appreciate that the removal of certain options is one of the ways by which FRSME achieves a simplification of full IFRS. However, we do not believe that the re-introduction of this option is a significant complication. The extra provisions required could be located in a specific sub-section at the end of section 17 that need only be consulted by those entities that had taken the option. (We acknowledge that the provisions required extend beyond the simple permission to revalue, but will also need to deal with the consequential effect on depreciation, impairment and reversals of these.) Notwithstanding this pragmatic consideration, we do not believe that the revaluation option should be extended to intangible assets; few entities do revalue these assets, a reliable value can be difficult to establish, and in any case IAS 38 *Intangible Assets* imposes considerable restrictions on revaluation.

The option in UK GAAP to capitalise borrowing costs should be retained

27. FRSME requires borrowing costs to be expensed, differing from IFRS, which requires capitalisation, and UK GAAP, which contains a capitalisation option. We do not believe that the proposed FRSME treatment is appropriate in this area. For those entities who have taken advantage of the capitalisation option under UK GAAP, users have benefited from information fine-tuned to best reflect the underlying performance of the business and to meet their needs. The removal of this option is seen as a step backwards and particularly prejudicial by asset-intensive sectors such as registered social landlords, for which borrowing costs may be particularly significant as a percentage of profit and where banking covenants may need to be renegotiated. The very serious concerns of this sector about the impacts of removing the option should not be dismissed lightly. Furthermore, it could be argued that this would not be a simplification; the most straightforward treatment would be to allow those with a policy of capitalisation to continue with it while also allowing the many entities who simply expense borrowing costs to continue unchanged. For this reason, and because the costs of mandating capitalisation for all entities would exceed the likely benefits, we would equally not support imposition of the IFRS mandatory capitalisation requirement. This is likely to be felt to be inappropriate by many preparers and users alike, particularly at the smaller end of the spectrum.

Capitalisation of development costs should be required in some circumstances

28. Development costs, which may be capitalised under UK GAAP, and must be capitalised under full IFRS if they meet certain conditions, would have to be expensed under FRSME. We acknowledge that the FRSME approach does represent a considerable simplification when compared to the detailed requirements of IAS 38. However, we are concerned that prohibiting the capitalisation of development costs will have a significant and negative effect on some businesses, and indeed, on some industries. Entities in those industries where development activities tend to span multiple accounting periods have in many cases found that capitalisation has enabled their primary statements to more closely reflect their business models. The treatment proposed by FRSME would require them to depart from

this and in many cases these businesses are concerned that users may find it difficult to assess the significant change in the profile of profitability and asset values that such a shift will precipitate.

29. Consequently we believe that FRSME should be brought more closely into line with IAS 38 in this regard and require the capitalisation of development costs where the specified conditions are met, subject to the exemption explained below. This would also be consistent with the definition of an asset in section 2. We appreciate that this does represent a complication of the streamlined requirements of FRSME and that the many businesses without significant development activity will not benefit from this move. However, as the effects of prohibition on certain industries may be so far-reaching (and could necessitate a move to EU-adopted IFRS), we suggest that an amendment in this case may be desirable. It may also be possible to minimise the effects of this amendment by including an exemption from capitalisation on the grounds of 'undue cost or effort', such an exemption is already permitted by FRSME from the requirement to fair value associates, joint ventures, investment property or biological assets, so its use could be extended to development costs should the capitalisation provisions of IAS 38 be brought into FRSME.

Simplified approach to financial instruments is appropriate

30. We support in principle the simplified treatment of financial instruments contained within sections 11 and 12 of FRSME. The accounting literature for financial instruments under current UK GAAP is defective, particularly for the majority of entities who do not fall compulsorily within the scope of FRS 26 and 29, while the extensive requirements of IAS 39 and IFRS 7 and 9 are clearly excessive for those non-publicly accountable entities falling within the scope of FRSME. Consequently, sections 11 and 12 of FRSME represent a significant step forwards in this area.
31. Nevertheless, we do feel that some minor modifications are needed to these sections. We are concerned that as currently worded, some instruments that could reasonably be classified as 'basic' will fall into the 'other' category. This is particularly unsatisfactory given that IFRS 9 *Financial Instruments* has now provided much greater clarity in this area. One example is that debt instruments are required in paragraph 11.9(c) to be classified as 'other' where they contain an option to put them back to the issuer should specified future events occur. However, many such instruments contain provisions allowing them to be put back in the event of credit deterioration of the issuer or changes to tax regulations or law, and IFRS 9 recognises this by providing a fair value exemption for these instruments. This exemption should be replicated in FRSME to avoid instruments being pulled into fair value inappropriately. And paragraph 11.10(d) should be extended to include the breach of a loan covenant as well as actual default. In addition we are concerned that some specific types of financial instrument commonly used by registered social landlords may be pulled by FRSME into the fair value regime. We urge the Board to engage closely with this sector before finalising the financial instruments section.
32. Paragraph 12.18 would seem to preclude net investment hedging with a loan, at consolidated accounts level. This is a common hedging arrangement that is permitted by both UK GAAP and full IFRS and therefore a modification to the paragraph to permit this would be welcome.
33. Generally these issues have arisen as the IFRS for SMEs has not yet been updated for the latest requirements embodied in IFRS 9, and therefore these departures from the IFRS for SMEs may only be required on a temporary basis until those updates are made.

Agriculture

34. One notable example of the IFRS for SME' s simplification of full IFRS relates to the fair valuing of biological assets. We recognise that some businesses, particularly those engaged in forestry or other multiple year activities, may value the opportunity to recognise biological assets at fair value, thereby better aligning their balance sheets with the underlying asset base. However, our understanding is that the majority of UK farmers operate with a single year cropping or production cycle, and for these businesses it is likely that any benefits arising from applying fair value would be significantly outweighed by the costs of producing such a valuation. The inclusion within section 34 of FRSME of an 'undue cost or effort' exemption from the fair value requirement is thus particularly pertinent, although we understand that relatively few UK agricultural businesses would fail to meet the criteria for following the FRSSE. We suggest that the Board ensures that the implications for this important sector are well understood before FRSME is finalised.

Grants

35. The FRSME treatment for capital grants differs from both the current requirements under UK GAAP and those in full IFRS, and could result in the deferral of income, potentially for several years, where a particular grant contract contains residual performance obligations and claw-back provisions. This may lead to a radical alteration in the income profile of entities in receipt of this type of grant, without any benefit to users of their accounts. We urge the Board to assess the concerns of sectors likely to be particularly affected, such as the farming and higher education sectors, and to consider whether it may be appropriate to amend FRSME in this regard to bring it in line with the treatment currently contained within IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.

Elements of UK GAAP not addressed in FRSME should be considered for retention

36. There are a few elements of current UK GAAP which do not have equivalent requirements within IFRS. We understand the Board now plans to incorporate FRS 30 *Heritage Assets* within FRSME and we support this decision. But a further example is UITF 32 *Employee benefit trusts and other intermediate payment arrangements*, an Interpretation providing useful instruction which would be lost were it to be withdrawn. We therefore suggest that the principles of this Interpretation could be retained in FRSME as guidance material. Furthermore, paragraph 13 and 16 to 19 of FRS 6 *Acquisitions and Mergers* contains useful principles for dealing with business combinations under common control. We urge the Board to conduct a thorough review of current UK GAAP to identify all of those areas without equivalent requirements in FRSME and to consider their retention.

Other suggested changes

37. Section 33 (related party disclosures) does not allow any disclosure exemption for transactions with or between wholly owned subsidiaries, despite this exemption being contained in section 72(4) of the company law Regulations. As the Board has established in paragraph 5.7(c) of the FRED part 1 that the IFRS for SMEs should be amended to avoid gold plating of company law, we believe that this exemption should be replicated in FRSME and also in paragraph 14 of *Application of Financial Reporting Standards* for qualifying subsidiaries that opt to apply Tier 1S.
38. Paragraph 7.11 stipulates that the actual rate must be used in translating cash flows in foreign currencies for the purposes of compiling the cash flow statement. However, in many cases this may be impractical and this difficulty is recognised in paragraph 30.8, which permits use of the average rate instead. As the IFRS for SMEs is currently silent on this

issue in section 7 we feel that the most straightforward solution would be to include a reference to paragraph 30.8 below 7.11.

39. The proposed wording of paragraph 9.1 does not acknowledge that FRSME applying groups may be required to consolidate by other regulations, we therefore suggest that the first sentence of paragraph 9.1 be revised to read; 'this section applies where an entity is required to prepare group accounts (consolidated financial statements) in accordance with its governing regulations (for example the Companies Act 2006; 'the act')'.
40. A reference is made in section 9.16 to the Regulations. We believe that reference could also reasonably be made to any other relevant legislation and therefore would suggest that the wording be amended to reflect this. This is a particular concern in the context of unincorporated entities.
41. There are cross-references in sections 2.35, 10.6, 35.1, 35.4 and in the glossary to 'full IFRS', we believe that this should read 'EU-adopted IFRS'.
42. Financial instruments associated with equity-settled share based payments are scoped out of section 12 by paragraph 12.3(e). This paragraph however does not cover cash-settled share based payments and therefore we suggest that its extension be considered.
43. Sections 14.4 and 15.9 refer to an accounting policy 'election' in the headings. The word 'election' is not correct in the UK context as the treatment is mandated by company law, therefore we suggest that the words 'accounting policy election' be deleted.
44. Section 21.9 has been amended from the IFRS for SMEs to recognise the restriction on set-off under company law. However, it now entirely omits the income statement treatment, which is unhelpful. We suggest that a sentence dealing with the income statement treatment be included.
45. IFRIC 17 *Distribution of Non-cash Assets to Owners* scopes out non-cash distributions between entities under common control. This exemption has not been replicated in section 22.18 of the IFRS for SMEs, and although being considered for adjustment by the Board was rejected because 'this was unlikely to create issues in practice as intercompany distributions are rarely declared before being made'. We disagree with this conclusion; IFRIC 17 does not only deal with recognition, it also covers the measurement of non-cash dividends and, therefore, the gain to be recognised in profit or loss on derecognising the distributed assets on settlement of the dividend obligation (while FRSME does not specifically require this gain to be recognised in profit or loss, there is no basis on which it could be taken directly to equity). This gain will need to be calculated even when the distribution is declared and made at the same time and, without this scope exclusion, the requirements of FRSME for those entities making non-cash distributions between entities under common control would therefore be more onerous than EU-adopted IFRS.
46. As drafted paragraph 28.25(c) of FRSME differs significantly from existing UK GAAP and IAS 19 as it requires actual returns on plan assets to be included in the profit and loss account. This will cause considerable volatility in profits. It is not clear whether this was deliberate in the drafting of the IFRS for SMEs as there is no definition of 'returns on any plan assets' in the Glossary. We suggest clarifying that it should be expected returns that should be included in the profit and loss account and defining the term in the Glossary.
47. Section 33, which is based upon IAS 24 *Related Party Disclosures*, identifies associates as being related parties. However, while IAS 24 then provides a reference to the definition of

an associate, this is omitted in section 33. We suggest that a reference be made here to the definition in section 14 *Investments in Associates*.

48. In the glossary we note that EU-adopted IFRS has been entered under F rather than E, that the term IFRIC needs to be updated to IFRSIC, and that the definition of related party transaction should be updated to be consistent with IAS 24 *Related Party Transactions*.
49. Paragraph 4 of FRED 43 defines a 'qualifying subsidiary undertaking', but for an undertaking to qualify it must be more than just not 'publicly accountable'. The definition should be expanded to include the other qualifying criteria.

ADDITIONAL GUIDANCE MATERIAL

50. In addition to the specific amendments outlined above, we believe that it is also desirable for FRSME to contain some additional guidance to assist with its application in the UK. In particular the relationship with UK company law should be considered. The formats of the primary statements and the headings to be used are set out in the Regulations, and therefore preparers will have to contend not only with unfamiliar terminology in FRSME, but also with translating that terminology into the headings used in the statutory accounts. In addition, company law also contains a number of additional GAAP requirements over and above those of FRSME.
51. We would not support a 'one-stop-shop' version of FRSME, combining company law requirements with the original text. Such an approach would produce a cumbersome, unwieldy document that was difficult for preparers to navigate. Commercially available checklists and textbooks can much more effectively meet this need. However, we do feel that the ASB should provide a bridge between FRSME and the requirements of company law. We would foresee this as adding three additional elements to FRSME. Firstly, a set of sample primary statements should be provided as suggested in paragraph 17 above. Secondly, FRSME should include an introductory chapter for the UK. And finally, we feel that there are some places where FRSME could benefit from explanatory text boxes embedded within the relevant sections to give the UK perspective.

Introductory chapter

52. An introductory chapter could be included within FRSME to acknowledge and explain the interaction with company law (for those entities to which it applies) and to provide references to the relevant legislation. It would start with the company law concept of true and fair view, relating that to the fair presentation terminology of section 3. It would then give a reconciliation of the primary statements in company law with those of FRSME, and explain that the Companies Act format requirements and the lists of items to be included in the primary statements, particularly in sections 4 and 5 are complementary. This chapter could then go on to provide definitions of FRSME terminology, providing a bridge between FRSME terms and those of company law. We acknowledge that the IFRS for SMEs glossary has been reproduced in FRSME, but we feel that this could be made more prominent and could be adapted to make reference to familiar Companies Act terminology. Such an introductory chapter would be of great value on first issue of the FRSME: in later versions its message may not be so important and it could be appropriately relegated in the document.
53. Two examples of terms that could usefully be explained in a UK context are 'contingent rent' and 'closely related' from section 12. In addition we feel that 'separate' financial statements are inadequately defined in section 9. An explanation of this term and its relationship to the Companies Act term 'individual accounts' would be useful.

Additional guidance

54. As well as an introductory chapter we would suggest that explanatory text boxes be added to the relevant sections for the following items.
55. The period over which management should assess going concern is stated in section 3.8 as being 12 months from the reporting date. However, the auditing standards refer to assessment for 12 months from the date of approval and it would therefore be useful for this to be noted in FRSME, since that standard is more directly relevant to preparers than are auditing standards. Alternatively, the appropriate wording from FRS 18 *Accounting Policies* could be added to FRSME.
56. Sections 4.2 and 5.5 list the headings for the primary statements. As we have noted above, the format of those primary statements is actually prescribed by company law and therefore the order of headings, as well as the terminology, given here will be unfamiliar to UK preparers. If our suggestion to include within FRSME a set of sample primary statements is heeded, then it may be appropriate to include a grey box below paragraphs 4.2 and 5.5 cross referring to these. In any case, we think it would be helpful if these sections carried additional guidance confirming what 3.22 says, that the terms in the FRSME do not have to be used.
57. An accounting policy election is contained in section 9.26, which gives a choice of fair value or cost less impairment when accounting for investments in subsidiaries, associates and joint ventures. However, were a policy to be adopted to take fair value gains or losses through profit or loss then extensive additional disclosure requirements under the Companies Act would be triggered. A text box would be useful to explain this fact.
58. Currently FRSME avoids the term 'derivative'. We believe that the term is actually widely understood in the business world, is in fact included in company law, and moreover that its omission may create more confusion than it avoids. Some linking of the term with the text of sections 11 and 12, or the selective use of the term in those sections may therefore be desirable.
59. Section 19 *Business combinations and goodwill*, has been considerably simplified from full IFRS and it could be argued does not now provide sufficient guidance. Firstly it would be beneficial to have some assistance in identifying a business, and therefore we suggest the inclusion of the relevant material from IFRS 3. Secondly, there could usefully be more about determining fair value. It should be noted that some large and complex businesses will fall to be accounted for under the FRSME and therefore businesses combinations falling within its scope have the potential to be extremely complex. Additionally, the group reconstruction provisions contained in FRS 6 *Acquisitions and Mergers* are not replicated in section 19, which could therefore raise questions for UK preparers, particularly if they are taking advantage of the merger relief provisions in the Regulations. We therefore suggest that the principles of FRS 6, paragraphs 13 and 16 to 19, be included within FRSME as additional guidance material. Finally, in 19.24b the Board have amended the requirements of the IFRS for SMEs in respect of 'negative goodwill', but the amendment does not explain what you do when there are no or minimal non-monetary assets against which it can be recovered.
60. Paragraph 28.38 considers group plans and permits subsidiaries participating in such plans to account on the basis of a reasonable allocation of the group expense, provided that certain criteria are met. However, the criteria are very restrictive and often may not be met, and the standard is silent on what they must do otherwise. Such plans are not multi-employer plans, as defined, and so it may be questioned whether the subsidiaries are intended to do full defined benefit accounting. It is also unclear what should be the

treatment of the parent in its own individual accounts, which are not covered by the 28.38 approach.

61. Paragraph 35.10(i) provides an exemption for pre-existing service concession arrangements (SCAs) but it is unclear whether the exemption applies prospectively or is purely retrospective. Not only does this raise application difficulties, but if the exemption is taken to be only retrospective, continuing contracts would fall to be accounted for under two separate regimes. Furthermore, paragraph 35.10(i) does not stipulate how exempted SCAs should be accounted for, merely that FRSME does not apply to them. Entities would as a consequence have to revert back to paragraph 35.7, which is inadequate in a complex situation such as this.
62. Treatment on adoption is also unclear for deferred tax. Paragraph 35.10(h) provides a transition date exemption on the basis of undue cost or effort, but it is not clear what the subsequent treatment should be where the exemption is taken.
63. Goodwill may also be an issue on transition for those entities that have previously asserted it to have an indefinite useful economic life. As FRSME requires a finite UEL to be determined, this is likely to be a significant issue for those entities to which it applies. However, FRSME is silent on how this transition should be approached. This lack of transitional guidance for goodwill could also have significant tax implications.
64. Given the move to XBRL filing by HMRC and Companies House, the Board should also give some thought to the development of an XBRL taxonomy for FRSME. To the extent that FRSME diverges from the IFRS for SMEs, and to take account of the Companies Act headings, amendments to the IFRS for SMEs taxonomy are likely to be necessary. It would be desirable for the Board to consider how these taxonomy issues will be dealt with well in advance of the transition date to FRSME.

RESPONSES TO SPECIFIC QUESTIONS

The tier system

Q1 Do you agree that a differential financial reporting framework, based on public accountability, provides a targeted approach to relevant and understandable financial information that contributes to discharging stewardship obligations?

65. We agree in principle that public accountability is the correct criterion to determine tier 1 membership and we agree with the definition developed (although we have set out in paragraphs 12 to 15 our concerns with its application). One of the purposes of financial reporting is to allow users to assess how successfully management have discharged their stewardship obligations and we agree that the proposed tiers 1 and 2 provide an appropriate framework within which this can be achieved. However, we question whether it is necessary to retain FRSSE as a third tier. Our concerns and suggestions in this regard are set out in paragraphs 7 to 9.

Q2 Do you have any further comments on the proposed application of the tier system?

66. See paragraphs 12 to 15 above.

Q3 Appendix 1 'Note on the Legal Requirements in the United Kingdom and Republic of Ireland' to this FRED sets out a note on legal matters that are applicable to the tier system. Do you have any comments or queries on the scope or content of this Appendix?

67. Yes, we are concerned that there may be currently be a legal impediment preventing those entities adopting tier 1 from moving back down to tier 2 should their circumstances change. We urge the Board to work with BIS to find an appropriate resolution to this issue.

Entities with public accountability (Tier 1)

Q4 Should entities that have public accountability, satisfy all three of the size conditions of a small company or small group, and are prudentially regulated, be permitted to apply the FRSME?

68. Yes, we agree. However, in paragraph 15 above we suggest that this exemption be widened beyond prudential regulation.

Q5 Are the definition of public accountability and the accompanying application guidance sufficiently clear to enable an entity to determine if it has public accountability? If not, why not?

69. No, we accept the definition itself but we are concerned that further development is necessary in its application. These concerns are set out in paragraphs 12 to 15.
70. In particular we are concerned about the appropriateness, on cost / benefit grounds, of extending EU-adopted IFRS to all pension schemes. For example, the extensive disclosure requirements of IFRS 7 *Financial Instruments: Disclosures* would impose a significant burden on pension schemes that, as we explain further below, would result in little or no benefit to users of pension scheme accounts. Furthermore, unlike companies, pension schemes do not have investors and are not required to file their accounts centrally and so we question whether comparability is beneficial or relevant. Pension schemes have long been considered a special case in UK financial reporting terms and, whilst the Pensions SORP is admittedly not perfect, we believe it offers a far more appropriate accounting regime than EU-adopted IFRS. We therefore question whether users would value the move to IFRS reporting, and suggest the Board consults with users of pension scheme accounts to determine if there is significant support among them for EU-adopted IFRS reporting. Any consideration of the costs and benefits of requiring pension schemes to report under IFRS should take into account the fact that, in the UK, the provision of key financial information about a scheme to its members is governed by regulation and that information is not confined to scheme accounts. For example, schemes are required to provide summary funding statements, statements of investment principles and recovery plans, in addition to the scheme accounts. The requirements for scheme accounts need to be considered within the context of that overall information package. It should also then be considered whether any amendment to the SORP would be necessary, were pension schemes then to fall instead into Tier 2, to take account of the exemption from the recognition of scheme liabilities contained in the Occupational Pension Schemes (Disclosure of Information) Regulations. This exemption is included in EU-adopted IFRS by IAS 26 Accounting and Reporting by Retirement Benefit Plans, but is absent from FRSME.

Entities without public accountability (Tier 2)

Q6 The ASB is proposing to amend the IFRS for SMEs to comply with Company law. Do you agree with the amendments? If not, please explain your reason for disagreement and, if appropriate, suggest an alternative.

71. In general we agree with these amendments, although we set out some reservations in paragraphs 19 to 49. Furthermore, we believe that some additional guidance material, as per paragraphs 50 to 64 is desirable to illustrate the interaction between FRSME and company law.

Q7 The ASB decided to evaluate possible amendments to the IFRS for SMEs using three guidelines:

- (a) changes should be minimal;**
- (b) changes should be consistent with EU-adopted IFRS; and**
- (c) use should be made, where possible, of existing exemptions in Company law to avoid gold-plating. Do you agree with these guidelines? If not, please explain why.**

72. We agree. The IFRS for SMEs is an appropriate replacement for UK GAAP for non-publicly accountable entities and therefore we would agree with (a) that changes should be limited to those that are essential. We also agree with (c), that gold plating of company law should be avoided. And generally we agree with (b), that those changes which are made should bring FRSME into line with EU-adopted IFRS; we have identified several key areas in paragraphs 19 to 49 above where we believe change is merited, and in all cases FRSME requirements differ from EU-adopted IFRS. However, we do not believe in all of these cases that the correct answer is merely to revert to EU-adopted IFRS. Our guiding principle is that UK accounting principles and practice have been well developed over a number of years to meet users requirements for decision useful information. There are a few areas where treatment in the IFRS for SMEs is more simplistic than current UK practice, namely [borrowing costs and] development costs, and in these cases we believe it is most appropriate, and certainly most acceptable to UK preparers and users, to retain the options currently available under UK GAAP.

Q8 The ASB has amended the IFRS for SMEs to:

- (a) replace section 29 Income Tax with IAS 12 'Income Taxes';**
- (b) provide transitional relief for dormant entities with intra-group balances;**
- (c) exempt an entity preparing consolidated financial statements from including a parent company cash flow statement; and**
- (d) revise the scope of section 9 such that an entity is required to prepare consolidated financial statements only when required to do so by Company law.**

Do you agree with the amendments? If not, please explain your reason for disagreement and, if appropriate, your proposed alternative.

73. (a) We agree that section 29, Income Tax, of the IFRS for SMEs needs to be updated as it is based upon a proposal for mainstream IFRS that was not subsequently pursued. The Board has followed a logical course in proposing an IFRS based alternative. However, we do not accept that verbatim inclusion of the text of IAS 12 *Income Taxes* is the most appropriate solution and we suggest that a simplified version of the standard be included instead. This solution does have the disadvantage that change to the income tax section is effectively locked-in at the next update of the IFRS for SMEs, but we believe that it is a preferable option to the UK 'going it alone', either by retaining the current UK GAAP treatment or by creating an entirely new regime.
- (b) We agree with these proposals.
- (c) We agree with these proposals.
- (d) We agree, however the wording chosen implies that consolidation can only be performed when required by the Companies Act. In fact entities, whether incorporated or not could opt to prepare consolidated financial statements, or be required by their non-Companies Act legislation to do so, and therefore we suggest the wording be amended to reflect this.

Small entities (Tier 3)

Q9 Do you agree with the proposed consequential amendments to the FRSSE? If not, why not? Please state your reason for disagreement and, if appropriate, suggest an alternative.

74. We have no comments to add on this point.

Q10 The ASB is proposing that subsidiary undertakings which apply the reduced disclosure framework should:

- (a) disclose the disclosure exemptions taken;**
- (b) state in the notes the name of the parent undertaking in whose consolidated financial statements the subsidiary's results and relevant disclosures are included; and**
- (c) only be permitted to take the disclosure exemptions where the consolidated financial statements of the parent are publicly available.**

Are these requirements necessary and sufficient to protect users of subsidiary financial statements?

75. In principle we agree with this requirement, and we note that in each case the exemptions are conditional on 'equivalent disclosures' being 'included in the consolidated financial statements of the parent'. However, in some cases it can be quite ambiguous as to whether the consolidated disclosure is actually 'equivalent'. Therefore we suggest that some robust guidance on the interpretation of 'equivalent' would be desirable. We also have a specific concern regarding loan covenants; were a subsidiary to have breached covenants this fact would be of great interest to readers of its separate financial statements and would be likely to have an influence on their decision making, the inclusion of that disclosure in the parent's borrowings note alone would not be sufficient. Disclosure of breaches of loan covenants, where material, should be required in subsidiary financial statements regardless of the disclosure made at consolidated level.

Q11 The ASB proposes that disclosure exemptions should be permitted for all subsidiary undertakings: do you agree, or do you consider that there should be a minimum percentage ownership requirement?

76. We agree that all entities falling within the definition of 'subsidiary' should be eligible for the subsidiary disclosure exemptions.

Q12 Do you consider that a disclosure exemption should or should not be provided for transactions between wholly-owned group undertakings? Please explain your reasoning.

77. An exemption from the related party disclosure requirements for transactions with or between wholly owned subsidiaries is contained in company law (section 72(4) of the Regulations). The ASB has established in paragraph 5.7(c) of the FRED part 1 that the IFRS for SMEs should be amended to avoid gold plating of company law, and we believe that following this principle it would be appropriate to replicate the exemption in FRSME (and also in *Application of Financial Reporting Standards* for subsidiaries applying Tier 1S).

Q13 The reduced disclosure framework was developed in response to the feedback on the ASB's policy proposal issued in August 2009. Qualifying subsidiaries applying the reduced disclosure framework look to EU-adopted IFRS and the Appendix to the draft Application FRS to prepare their financial statements. Does this proposal adequately address preparers' needs?

78. Yes, we believe that the proposed reduced disclosure framework does meet the needs of preparers. However, we draw your attention to our comments in paragraph 75 above regarding equivalent disclosures and users.

Q14 Do you have any further suggestions for disclosure exemptions for qualifying subsidiaries? If so, please explain why you consider the disclosure is not required in the subsidiary financial statements.

79. We agree with the reduced disclosure framework as set out in the FRED. However, the Board may additionally wish to consider whether the exemption from the requirement to present certain comparative figures should not equally be extended to the third balance sheet.

SORPs for profit-seeking entities

Q15 Do you agree with the detail of the ASB's proposal to streamline the number of SORPs for profit-seeking entities? If not, why not?

80. Before finalising the new regime for UK GAAP we urge the Board to ensure it has completed adequate consultation procedures with each of the SORP making bodies. In some cases amendments may be necessary to align the SORP with the new framework or to ensure that disclosure requirements are consistent with the proposed new reduced disclosure regime for subsidiaries.

Q16 Do you agree with the benefits that have been identified as arising after adoption of the proposed Financial Reporting Framework? If not, why not? Please provide examples, including quantification where possible, of any benefits you believe have not been taken into account.

81. Generally we agree with the benefits as expressed by the Board. We agree that, providing the suggestions we make in paragraphs 19 to 49 are heeded, FRSME is simpler and easier to apply than current UK GAAP. As such, this can be expected to reduce compliance and training costs. However, it should be noted that in paragraphs 7 to 9 we suggest that on balance a two tier framework would be preferable. In our view a two tier solution would be more proportionate and go further toward achieving a common framework than the proposed system retaining the FRSSE.

Q17 In relation to the case study scenarios identifying the likely costs of transition for certain entities, do you agree with the nature and range of costs identified? If not, please provide details of any alternatives you would propose, including any comments on the assumptions underlying the calculation of the costs.

82. We appreciate the efforts of the Board in conducting the impact assessment and recognise that proper due process demands that such an exercise be performed. It must be accepted that neither the estimate of costs nor that of the benefits contained within the FRED can be claimed with any confidence to be accurate or complete; the costs as stated may be underestimated. But we do not perceive this to represent a particular disadvantage. There will be significant up-front costs to change, but moving to the much simpler and up to date regime offered by FRSME is likely to result in real, on-going savings over the longer term. Therefore we are confident that the overall effects of the proposals will be positive, and we intend to do all we can to smooth the transition for our members and others affected by the change. The Board should plan to do the same.

Q18 The [draft] Impact Assessment also gives an indication of the impact on the 'main affected groups'. Do you agree with this analysis? If not, why not?

83. See paragraph 81 above.

Q19 The benefits are hard to quantify; do you agree that they outweigh the costs of transition and any ongoing incremental costs? Do you have any comments on the estimates used?

84. See paragraph 81 above.

Q20 The ASB is proposing an effective date of July 2013, with early adoption permitted, which assumes an 18 month transition period. The ASB's rationale for this date is set out in paragraphs 11.121 to 11.126. Early adoption will permit entities to secure benefits as soon as possible, however other entities may wish to defer the effective date to permit businesses more time to prepare for transition. Do you agree with the proposed effective date and early adoption? If not, what would be your preferred date, and why?

85. We agree that early adoption should be permitted. We also agree that at least a clear 18 month minimum period between publication and mandatory adoption will be necessary and would not oppose a later implementation date if this facilitates a smooth and orderly transition to a two tier arrangement. However, please also see our comments in paragraph 6 above about the need to allow adequate time for transition.

Q21 Please provide any other comments you may have on the [draft] Impact Assessment.

86. See paragraph 81 above.

Alternative view

Q22 Do you agree that all the entities that the ASB has identified as falling within Tier 1 should be in Tier 1, or do you agree with the Alternative View that some could move to other tiers? If you do think some entities could be moved– which entities and to which tier?

87. We do not agree with the main tenets of the alternative view and do not believe that the alternative proposals would be operable or that they would result in greater positive effects than those of the Board. In particular we are opposed to the simplified treatment suggested for deferred tax; this can be a very material balance for small entities and therefore we do not accept on balance that flow-through would be appropriate.

88. Overall we are supportive of the Board's direction of travel and subject to the points raised in our responses being addressed, and recognition that there are and will continue to be different points of view on the proposals, believe that it represents the best way forward for UK GAAP.

Q23 Are you aware of any information that users of financial statements of publicly accountable entities require which would not be disclosed in financial statements prepared using the FRSME (the IFRS for SMEs adapted for use in the UK)? If so, please identify such information and explain why it is required.

89. As per paragraphs 87 and 88 above, we do not agree with the main tenets of the alternative view and therefore in general do not believe that the disclosure requirements of FRSME are adequate for 'publicly accountable' entities. However, for certain regulated entities, specifically those satisfying all three of the Companies Act small criteria and pension schemes we believe that the safeguards provided by regulation can be sufficient to negate the additional benefits that can be gained by moving to EU-adopted IFRS. Therefore we are comfortable that it is appropriate for these entities to apply FRSME if the regulator's activities justify it. For other 'publicly accountable' entities FRSME would not be suitable.

Accounting requirement for entities falling into Tier 2 (FRSME)

Q24 Do you believe that the ASB's proposals for the FRSME should be changed to reduce complexity? If so, what changes would you suggest? Please explain how such changes would improve the balance between costs and benefits.

90. We have set out some important suggested changes that we believe should be made to FRSME in paragraphs 19 to 49 above. However, in general we believe that the IFRS for SMEs does provide a suitable basis for UK GAAP for non-publicly accountable entities.

Q25 If the FRSME was changed in accordance with your response to Q24, would it still be suitable for use by some publicly accountable entities? If not, why not?

91. No. FRSME was not designed for use by publicly accountable entities and we would not support its extension beyond those entities described in paragraph 89 above.

Boundary between Tier 2 and Tier 3

Q26 The current cut-off point for the FRSSE is the small company threshold (Turnover £5.6m, Balance Sheet £2.8m, Employees 50). Do you think the cut-off could be raised to permit all companies defined as medium-sized (Turnover £22.8m, Balance Sheet £11.4m, Employees 250) under the Companies Act to use the FRSSE without any additions to the FRSSE? If not, can you identify an intermediate level for the cut-off, and what would it be?

92. No. Subject to the important caveats expressed in paragraphs 7 - 9 above, we support a move to a two tier system, with FRSME forming the lowest tier. As set out in paragraphs 7 – 9, the end result is likely to still provide some differential requirements for small entities, with certain exemptions preserved. The scope of these exemptions would need to be explored further in any consultation on the future of FRSSE. It is also important for the final decision on the new accounting regime to be coordinated with decisions taken in Brussels, should movement on the micro-entity proposals be apparent.

Q27 If you consider that the upper limit of the FRSSE could not be raised without amendment, what additional topics would the FRSSE need to cover if it was extended to include medium-sized entities, and why?

93. See paragraph 92 above.

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SUGGESTIONS FOR THE NEXT REVISION OF THE IFRS FOR SMES

- A1 In this appendix we highlight some areas which, while not meriting adjustment to FRSME in view of the preference not to tinker with IFRS for SME wording just for the sake of wording preference, could usefully be borne in mind by the IASB at the next revision of the IFRS for SMEs. We will also be forwarding these points to the IASB.
- A2 The drafting of section 9.18 is rather unclear. The section states:
- ‘the difference between the proceeds from the disposal of the subsidiary and its carrying amount as of the date of disposal, excluding the cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in equity in accordance with section 30 *Foreign Currency Translation*, is recognised in the consolidated statement of comprehensive income ... as the gain or loss on the disposal of the subsidiary’.
- We believe that this section is prohibiting the recycling of foreign currency gains or losses on disposal, but from the wording used we are concerned that it could be taken by the reader to mean either prohibiting or requiring recycling.
- A3 The hedging provisions in section 12 have been substantially condensed from those in IAS 39, and we welcome this simplification in principle. However in practice we believe that entities wishing to hedge account will find section 12 difficult to apply. Given that the IASB is currently working to revise the hedge accounting requirements, we would expect that this section will be revised in due course and as part of that exercise would urge them to fully review its ease of use for those entities who will apply it.
- A4 We are also concerned about the wording in paragraphs 12.3(f), 11.7(c) and 20.1(e), which identify those leases that will fall under the financial instruments section. We do not believe that this paragraph is well enough explained for readers to unambiguously decide whether their leases are in scope or out. In paragraph 53 above we suggest that some additional guidance on the terms ‘contingent rent’ and ‘closely related’ should be included within FRSME, but the IASB may also wish to consider clarifying this paragraph in the IFRS for SMEs.
- A5 In the basis of conclusions to IAS 20 *Government Grants and Disclosure of Government Assistance* the IASB clarifies that interest should be imputed in accordance with IAS 39 for loans from government bearing a below market interest rate. This guidance is not replicated in section 24 of the IFRS for SMEs, which is silent as regards imputed interest. We suggest that the IASB may wish to consider clarifying this point at the next revision of the IFRS for SMEs.