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Mr Paul Pacter
IASB Director of Standards for SMEs
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Exposure Draft of a Proposed IFRS for Small and Medium-sized Entities

Dear Mr Pacter,

We are pleased to comment on the Exposure Draft of a Proposed *IFRS for Small and Medium-sized Entities* (referred to as 'the ED' or 'the proposed Standard'). Our responses to the questions raised in the ED are set out in Appendix A and is supported by Appendix B which includes detailed comments on specific sections of the proposed Standard and Appendix C which details our views on specific cross-references to full IFRS. In our responses to the questions raised in the ED we are focusing on the type of transactions the IASB had in mind when drafting the IFRS for SME; that is, transactions of entities with about 50 employees.

We continue to support the IASB's efforts to develop an appropriate and comprehensive reporting regime for SMEs. This is a once in a generation opportunity for the IASB to fill the void for SMEs. The need for such a regime will also increase as the full suite of IFRS becomes more complex to apply and full IFRS is primarily directed to serve the needs of sophisticated capital market participants. We believe IFRS for SMEs should focus on improving communication between the SME and its users. However, this needs to be done such that it satisfies the needs of SME users, whilst still meeting the cost/benefit criterion. We strongly support the IASB in their pursuit of this objective; however, we think that further progress could be made.

There is strong demand globally for the introduction of an IFRS for SMEs. As a global issue, we believe that the resulting ED produced by the IASB is a fair compromise given the competing priorities of different jurisdictions and represents a good starting point from which debate and changes may be made to create an effective standard for SMEs.

The key matters we have raised in the Appendices to this letter are:

- The final Standard should be a fully stand-alone document. We support the objective of a self-contained, comprehensive, set of standards for SMEs and do not agree that the IFRS for SMEs should contain *any* cross referencing to full IFRS, with the exception of financial instruments, as discussed in Appendix C. We believe that SMEs should be able to find all their financial reporting requirements in the one stand-alone document. Whilst we appreciate the need to keep the IFRS for SMEs concise, we do not believe that directing SMEs to full IFRS in certain situations is the most appropriate means of achieving this objective. Accordingly our proposal to minimise the need for cross-referencing is set out in Appendix C to this letter.
- The IFRS for SMEs has not addressed the needs of SME subsidiaries where consolidated financial statements are prepared by the parent company in accordance with full IFRS. Such entities are likely to prefer to apply the same recognition and measurement principles as applied by the group but with reduced disclosure. We believe that such an option should be included within the IFRS for SMEs.
- Further simplification of the recognition and measurement principles is required. The needs of users of SME financial statements are not as sophisticated as those of full IFRS financial statements and therefore the accounting requirements should be simplified. This may include further elimination of options, and/or, alternatively, increasing divergence from full IFRS. The proposals also appear to have unintended consequences that make the ED, in some respects, more onerous than for those applying full IFRS. For example, the ED currently imposes a fair value model more frequently on a SME than full IFRS reporters, primarily due to the elimination of options, for example the accounting for leases and impairment of non-financial assets. It is unclear to us why the cost model is unacceptable. A fair value methodology imposes significant annual costs on preparers and the ED fails to justify the appropriateness of this approach on cost/benefit grounds.
- Further disclosure relief is required. Although we acknowledge that the ED proposes significant disclosure relief when compared to full IFRS, we believe this is a key area where simplification has not gone far enough. Further enhancements are possible without any risk of not satisfying the information need of users. Please refer to our response to question 9 for further comments on the adequacy of SME disclosures.
- Clarification that the IFRS for SMEs is not part of the IFRS hierarchy is required (possibly via an amendment to IAS 8). We are concerned that in circumstances where full IFRS is silent on a transaction, condition or event, users of full IFRS may be required to analogise to the IFRS for SMEs for guidance. While we acknowledge that this is beyond the scope of this ED, we believe that it would be useful for the IASB to address whether the opposite would also be true, that is, under the hierarchy in IAS 8.10-12 whether guidance to full IFRS is found in the IFRS for SMEs for issues which are not addressed in full IFRS.

In addition, while we note that the proposed IFRS for SME framework reflects the principles contained within the current full IFRS framework, we believe that this may not be the case in the future if the needs of users of full IFRS diverge from the needs of users of IFRS for SMEs. We believe that the IASB needs to consider any such divergence as part of the current IFRS framework project.

Finally, in order to increase the use of the final standard in different jurisdictions would like suggest that the IASB consider whether it would be viable to make the final standard available free of charge on the internet.

If you have any questions concerning our comments, please contact Ken Wild in London on +44 (0) 207 007 0907.

Yours sincerely

Ken Wild
Global IFRS Leader

Appendix A

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?

We support the objective of a self-contained, comprehensive, set of standards for SMEs and do not agree that the IFRS for SMEs should contain *any* cross referencing to full IFRS, with the exception of financial instruments, as discussed in Appendix C.

We believe that SMEs should be able to find all their financial reporting requirements in the one stand-alone document consistent with the IASB's conclusion in the Basis for Conclusion, BC26, that separate standards for SMEs were appropriate. Whilst we appreciate the need to keep the IFRS for SMEs concise, we do not believe that directing SMEs to full IFRS in certain situations is the most appropriate means of achieving this objective.

In addition, we believe the current proposed cross-referencing to full IFRS will result in confusion when applying the ED. Where the IFRS for SMEs includes a cross-reference to full IFRS there is no clear and explicit guidance on which parts of the full IFRS apply to the SME. Further, under the current proposed approach, as IFRS are revised it is not clear which version of a full IFRS Standard the cross-reference refers. Consequently, the current approach adopted by the ED is likely to cause confusion and reduce the effectiveness of the IFRS for SME as a stand-alone document. The elimination of cross-referencing, where applicable, would alleviate these issues.

We also note that the Basis for Conclusions refers to three occasions when the IFRS for SMEs will require or permit entities to look to full IFRS; where options are permitted by cross-reference to full IFRS, cross-reference to omitted accounting topics on the basis that typical SMEs will not encounter them, and where the IFRS for SMEs does not address a transaction, event or condition. Our consideration of each of these occasions is as follows:

1. Options are permitted by cross-reference to full IFRS

   As explained in our response to question 4, we do not believe that all options available to full IFRS entities should be available to SMEs; subject to our concerns with respect to subsidiaries reporting obligations where they are also required to prepare financial information in accordance with full IFRS for the purpose of the parent's consolidated financial statements. If, however, an option in full IFRS is made available to SMEs, we believe that SMEs should be afforded disclosure relief. Currently on making options in full IFRS available via cross-references, SMEs would be required to comply with the disclosure requirements in the full IFRS standard.

2. Cross-referencing to omitted accounting topics on the basis that typical SMEs will not encounter them

   We believe the IFRS for SMEs should deal with all transactions that are common for SMEs. If the transactions are not frequent for a SME it should rely on the concepts and pervasive principles in Section 2 *Concepts and Pervasive Principles* in the IFRS for SME to develop an appropriate accounting policy. If it is considered of vital importance that SMEs who encounter certain transactions account for them in accordance with existing full IFRS, those requirements should also be included in the IFRS for SMEs.

   Our comments regarding the topics that were omitted from the draft IFRS for SMEs referred to in the Basis for Conclusions, BC58 to BC65, are included in our response to question 6.

3. Full IFRS may be looked to where the IFRS for SMEs does not address a transaction, event or condition

   We agree with the hierarchy contained in paragraphs 10.2 to 10.4. Where IFRS for SMEs does not deal with a specific transaction, event or condition, deferring to full IFRS should not be mandatory. We agree that the first reference point for users should be any similar issues dealt with in the IFRS for SMEs and the second reference point should be the concepts and pervasive principles contained in Section 2 *Concepts and Pervasive Principles*. In circumstances where it is not possible for management to make a decision on developing and applying an accounting policy using the information contained in the IFRS for SMEs then full IFRS should only be a potential source of additional guidance, not a compulsory reference point.

   It is, however, unclear how the hierarchy will be applied in practice as there is no guidance within the ED on how full IFRS (including IFRIC Interpretations) and IFRS for SMEs interrelate. As we note in question 2, both sets of Standards, that is, full IFRS and the IFRS for SMEs include topics not addressed in the other. We believe that it is clearer for SMEs that they are not required to refer to full IFRS; however, if entities are applying a similar framework it may be difficult to argue that a policy contrary to that required by full IFRS is appropriate. We also note that there is no guidance in full IFRS as to the relevance of IFRS for SMEs in their accounting. While we acknowledge that this is beyond the scope of this ED, we believe that it would be useful for the IASB to address whether the opposite would also be true, that is, under the hierarchy in IAS 8.10-12 whether guidance to full IFRS is to be found in the IFRS for SMEs where the IFRS for SMEs deals with issues which are not addressed in full IFRS.

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.

Although we acknowledge that the IASB has proposed some simplifications in the ED, we believe that further simplification is required to ensure that SMEs are able to apply the IFRS for SME in an efficient and cost effective manner. The Basis for Conclusion, BC21, recognises that the circumstances of SMEs can differ from those of larger, publicly accountable entities in several ways, yet we do not believe the IASB has factored these differences sufficiently into the proposed Standard when developing the ED.

Our comments on specific sections of the ED, included in Appendix B, fall into three general categories:

- further simplifications as the current simplification proposals are still too complex;
- introduction of simplifications to certain sections; and
- removal of requirements that are considered more onerous for SMEs than the requirements that currently exist for full IFRS reporters.

With respect to the last point, we believe some of the requirements of the ED are more onerous than those that currently apply to full IFRS reporters, and we do not believe the simpler or more appropriate option has been included in the IFRS for SME. In addition, the ED appears to pre-empt proposed full IFRS changes resulting from other IASB projects. For example, Section 28 *Income Taxes* includes a number of proposed requirements from the current IASB project on IAS 12 *Income Taxes.* We do not believe that this approach is consistent with the proposal of maintaining the IFRS for SMEs through an omnibus exposure draft every two years and is potentially imposing more onerous requirements on SMEs before full IFRS reporters. In other cases, the requirements may be seen to be inappropriately eliminating choices where a number of alternative options may be applied by full IFRS reporters.

Please refer to Appendix B for our detailed comments on each section of the ED including comments regarding simplification (Q2 and Q3) and adequacy of guidance (Q8).

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?

We believe that further simplifications can, and should, be made to the recognition and measurement requirements. In Appendix B we have included detailed comments on each relevant section of the ED regarding simplifications and adequacy of guidance. As part of these comments we have considered each of the simplifications the IASB decided not to adopt.

The sections where we believe further simplification should be made which the IASB decided not to adopt are:

- Share-based payments;
- Income taxes;
- Defined benefit plans; and
- Specialised industries – agriculture.

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?

We do not agree that all options in full IFRS should be available in the IFRS for SMEs. Whilst we agree that prohibiting SMEs from using an accounting policy option that is available for full IFRS entities would hinder comparability, we do not believe this is crucial for the ED as the users of SME financial statements are different to those of larger organisations. Consequently, the options themselves increase the potential for non-comparability. We believe the focus of the ED should be on improving communication with users of SME financial statements and reducing the complexity of their financial statements.

However, we note that a significant problem with only allowing certain options for SMEs is that this may create problems in accounting for subsidiaries within a group. Many jurisdictions require subsidiaries to prepare separate financial statements for regulatory purposes; not just for the purpose of consolidation. Consequently we believe that SMEs that are subsidiaries of full IFRS reporters need to have the same options available to them as their full IFRS parent entities. If such an exemption is not permitted, consolidation adjustments in respect of different accounting treatments will be required. However as indicated below and in question 9, we strongly believe that if this proposal is accepted, disclosure simplifications should also be available. Therefore we would propose an amendment to the application of the ED such that for those entities that are subsidiaries of full IFRS reporters, there should be the option to apply full IFRS; however, they should also be permitted to take advantage of the disclosure relief available to other SMEs. If adopted, this proposal would result in there effectively being three tiers of IFRS reporting:

- 'Full' IFRS;
- 'Full' IFRS with reduced disclosure for subsidiaries of IFRS reporters; and
- IFRS for SMEs.

Where existing options under full IFRS are made available to SMEs we disagree with how this has been achieved within the ED. Therefore, we suggest that all options available to SMEs should be included in the SME document and disclosure requirements should be simplified. The proposed method of cross-referencing to full IFRS means that entities choosing the 'non-SME' option are required to follow full IFRS disclosure. For example, in the case of property, plant and equipment should a SME choose to apply the revaluation model rather than the 'simpler' cost model they would need to apply the full disclosure requirements of IAS 16 *Property, Plant and Equipment*. The non-SME options then become the more onerous alternative, although may be a preferred method of accounting for a particular entity.

As explained in our answer to Question 1, we believe all cross-referencing to full IFRS should be eliminated, except in the rare circumstances that we have mentioned in Appendix C. The IFRS for SMEs should be a true stand-alone document.

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?

We support the option in Section 24 *Borrowing Costs* of allowing SMEs to choose either the expense model or the capitalisation model. We believe that maintaining the capitalisation model is necessary for entities in industries where qualifying assets are common; however, we do not believe the use of this method will provide more useful information to the users of SME financial statements. Therefore, even considering the amendments to IAS 23 *Borrowing Costs*, we do not believe the option to expense should be prohibited.

The implementation of the capitalisation of borrowing costs model requires sophisticated information systems. Therefore a prohibition of the expense model creates an administrative burden with no added value for the SMEs. We understand that many SMEs enter into very general financing arrangements, and therefore determining the appropriate costs for capitalising could be problematic.

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?

As stated in our response to Question 1, we believe that the IFRS for SMEs should be a stand-alone document. We do not support the use of any cross-referencing to full IFRS, except in the rare circumstances that we have mentioned in Appendix C. However, we agree that there is not a place in IFRS for SMEs for certain topics addressed in full IFRS. For example, we agree the IFRS for SMEs is not likely to apply to insurers and therefore insurance contracts are not covered. However, other topics, although not common for SMEs, may occur, particularly where the IFRS for SME is adopted for a large audience in different jurisdictions.

Please refer to Appendix B for specific comments on:

- Financial reporting in hyperinflationary economies;
- Specialised industries – agriculture;
- Share-based payment – equity-settled share-based payment transactions; and
- Leases – financial statements of lessors.

Finally, Section 31 *Segment Reporting* and Section 34 *Earnings per Share* should be removed from the ED as at a full IFRS level they apply only to listed entities, or entities in the process of listing, and therefore are unlikely to be applied by a SME. If a SME was to provide such information, we do not believe they should be required to follow the requirements of full IFRS but instead should disclose the basis of preparation in the notes to the financial statements.

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?

We are satisfied with the hierarchy in paragraphs 10.2-10.4. We agree that in the absence of specific guidance in the IFRS for SMEs, deferring to full IFRS should not be mandatory.

However as stated in our response to Question 1, we believe the relevant parts of full IFRS that are cross-referenced from the IFRS for SMEs should be included within the IFRS for SMEs document itself. This is so that the IFRS for SMEs remains a true stand-alone document.

In the context of extracting principles and related mandatory guidance from full IFRS the Basis for Conclusions, BC66, implies that the IFRIC's interpretations were factored into the drafting of the ED. Many of the IFRIC's interpretations do not appear to have been incorporated into the ED. It would be useful if the IASB clarified their status in the proposed IFRS for SMEs. For example, it would be useful to include commentary as to why some IFRIC interpretations have been included within the SME standard and others have not. As indicated in Appendix B, we believe some of the IFRIC's interpretations should be explicitly included as guidance in the IFRS for SME.

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?

We believe the general approach adopted by the Board of building the proposed Standard by extracting the main principles for each Standard has not resulted in sufficient guidance in the ED. Refer Appendix B for detailed comments on the following areas where we believe further guidance is required:

- Balance sheet – current liabilities;
- Financial assets and financial liabilities;
- Provisions and contingencies;
- Share-based payment;
- Business combinations and goodwill;
- Specialised industries – agriculture;
- Discontinued operations and assets held for sale;
- Employee benefits; and
- Cash flow statements.

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?

We believe that disclosure is a key area where simplification for SMEs is beneficial without significantly decreasing understandability and relevance to users. However, we believe that the ED does not go far enough in removing disclosures that do not provide benefit to the users in excess of the costs incurred to prepare those disclosures. We submit that only the principal disclosure standards, that is, IAS 1 *Presentation of Financial Statements*, IAS 7 *Cash Flow Statements,* IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and IAS 24 *Related Party Disclosures* should be mandatory along with any additional disclosures necessary to understand significant transactions and events. The disclosures required by IAS 34 *Interim Financial Reporting* may provide a basis for determining these key disclosures.

We note that the IFRS for SME includes two disclosures that we have identified as additional to the requirements in full IFRS:

- Paragraph 27.40 requires disclosures with respect to each category of termination benefits
- Paragraph 36.2 requires the breakdown of profit and loss related to discontinued operations without any exemption for disposal groups that are newly acquired subsidiaries as allowed by IFRS 5.33(b).

It is unclear why such disclosures are warranted for a SME when they are not required for a full IFRS reporter.

In addition, as indicated in question 4, we do not believe that where an entity reverts to an option in full IFRS that is not outlined in the IFRS for SME it should be required to comply with the full IFRS disclosures for that Standard. Although the Board selected the simpler option which they considered a SME might select when applying the proposed IFRS for SMEs, historical practices, parent entity accounting policies and the desire for comparability with larger organisations may mandate the more difficult option. This choice however will not have the effect that the users of the SME financial statements will expect the same level of disclosure as the users of full IFRS financial statements. Therefore, simplified disclosures should still be available to a SME even where it chooses to apply an option available under full IFRS.

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?

The proposed transitional provisions which are largely consistent with IFRS 1 *First-time Adoption of International Financial Reporting Standards* represent a useful starting point for IFRS for SMEs. However, we believe there are several issues that need to be resolved.

Not all transition exemptions in IFRS 1 are specifically noted in Section 38 *Transition to the IFRS for SMEs*, and therefore would not be available to a SME. These include some of the transition exemptions related to IFRIC Interpretations that are not specifically referred to in the ED (for example, IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, IFRIC 4 *Determining whether an Arrangement contains a Lease* and IFRIC 12 *Service Concession Arrangements*). It is questionable whether the transitional provisions related to these interpretations may be applied through the hierarchy. Also, the transition exemptions for assets and liabilities of subsidiaries, associates and joint ventures, and fair value measurement of financial assets and financial liabilities have not been included. It is unclear why an IFRS for SME reporter should not be able to utilise these transition exemptions. We therefore believe there should be consistency between full IFRS reporters and IFRS for SME reporters in this area.

Further, we do not support the inclusion of the new transition exemption for deferred income taxes, particularly as it is unclear whether the exemption for 'undue cost and effort' continues to be available in the years after transition. We presume that the exemption works in a similar way to the initial recognition exemption in the current version of IAS 12 *Income Taxes.* If the exemption is available at the date of transition for temporary differences existing at the date of transition, but not post-transition for those temporary differences, we are not sure that the transition exemption is helpful.

We believe there are good reasons for the mandatory transitional provisions of both the proposed IFRS for SMEs and IFRS 1 to be similar to prevent additional work being required each time an entity may transition between full IFRS and IFRS for SMEs. However, additional transitional provisions are required to cater for such an event due to the differences in accounting between full IFRS and IFRS for SMEs. One transitional provision that we believe would be of benefit to entities transitioning from full IFRS to IFRS for SMEs is an exemption to allow such entities to elect to use the previous full IFRS carrying value as deemed cost at the date of transition to IFRS for SMEs.

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?

We agree with the proposed cycle of two years for amendments to be made to IFRS for SMEs. However, given the amount of cross-referencing to full IFRS currently proposed in the ED, any change to full IFRS would have a potential consequential effect on the IFRS for SMEs. As outlined in question 1, this is one of the reasons why we believe the IFRS for SMEs document should be stand-alone.

If, however, the cross-references to full IFRS are not removed[1], the IFRS for SMEs should be clarified so that it is clear which version of the full IFRS Standard is being referred to. Additionally, in order not to potentially have two applicable different treatments according to whether an entity applies IFRS for SMEs or full IFRS, it is important that the major amendments made to full IFRS are immediately transferred to the IFRS for SMEs. To achieve this objective, we believe the IFRS for SME should be addressed in the exposure drafts of such 'major' amendments to full IFRS.

Further, we do not believe that the issue of new Interpretations of full IFRS should be used in the interpretation of IFRS for SMEs until they are specifically included within the IFRS for SMEs as part of the two year maintenance process. We believe that this point should be specifically stated within an IFRS for SMEs as reference to IFRIC Interpretations is not mandatory and as such it is not clear whether these only become effective as part of the two year maintenance process.

Finally, we would like to understand how the IASB intend to deal with requests for interpretation of IFRS for SMEs, that is, whether these would be accepted and who would be responsible for responding to these requests.

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[1] Please refer to our comments in question 1 for details of our concerns with this approach.

Appendix B

Following are our detailed comments on specific sections of the proposed Standard, particularly with respect to simplifications and adequacy of guidance.

Section 2 – Concepts and Pervasive Principles

While we understand that the concept of 'neutrality' has been deleted from the qualitative characteristics brought in from full IFRS because 'reliability' already incorporates the principle that the information should be free from bias, we suggest that either this explanation be included in the proposed Standard or preferably that 'neutrality' is included in the proposed Standard until such time as the *Framework* is amended.

Also, paragraphs 2.30 and 2.31 on the measurement of the elements of financial statements describe two common measurement bases; historical cost and fair value. Full IFRS includes other measurement bases (and not only fair value) that we believe have influenced measurements within the ED, therefore it is unclear to us what the implications of specifying only these two measurement bases for SMEs might be, since full IFRS has other measurement bases.

Section 4 – Balance Sheet

Current liabilities

In our view it is necessary to include, consistent with IAS 1 *Presentation of Financial Statements*, further guidance around the classification of current liabilities, particularly with respect to situations where an entity does not have the unconditional right to defer settlement for at least 12 months. This is an area that without further guidance, entities will possibly apply differently due to diverse interpretations on how to account for post-balance sheet date events.

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

Entities following full IFRSs will be required to present a statement of comprehensive income starting in 2009 (IAS 1 *Presentation of Financial Statements* revised September 2007). The IFRS for SMEs permits, but does not require, a similar statement (a statement of changes in equity that excludes ownership transactions with equity holders). The Board has not yet specifically addressed whether a requirement to present a statement of comprehensive income will be included in the final IFRS for SMEs. We believe that this should be discussed prior to the final SME Standard being issued. It is our view that it may be better for the Board to wait and gain some experience from the adoption of these amendments by full IFRS reporters before requiring an SME to prepare a statement of comprehensive income as a principal component of the financial statements. In addition, we believe that adding a requirement for a statement of comprehensive income may be a significant enough change to warrant the re-exposure of the SME exposure draft.

Section 7 – Cash Flow Statement

We believe a cash flow statement to be a key statement in the preparation of a set of financial statements and that users of SME financial statements will place significant reliance on it. Therefore, we do not believe that there should be significant divergence between Section 7 *Cash Flow Statement* of the draft IFRS for SMEs and IAS 7 *Cash Flow Statements*. Thus, we believe paragraph 7.10 of the ED should be amended to classify cash flows from acquisitions and from disposals of subsidiaries or other business units as investing activities.

In addition, we believe the following guidance from IAS 7 should also be included in the ED:

- when cash flows may be reported on a net basis;
- an entity should be allowed to use an exchange rate that approximates the actual exchange rate for foreign currency cash flows;
- guidance on investments in subsidiaries, associates and joint ventures; and
- guidance on acquisitions and disposals of subsidiaries and other business units.

<u>Section 9 – Consolidated and Separate Financial Statements</u>

Consolidated financial statements

We believe the need to prepare consolidated financial statements will depend on the users of the SME financial statements; for example, it will depend on other information they have and the purpose for which the financial statements are being prepared, and thus the decision to consolidate should be self-regulated by the entity applying the IFRS for SMEs. Therefore we believe that in the ED the preparation of consolidated financial statements should be optional for SMEs. If the entities take the option not to prepare consolidated financial statements, they should be required to provide additional related party disclosures, for example including the names of subsidiary holdings, the number of voting rights held for each subsidiary, financial information for each subsidiary, and shares in the company held by its subsidiary undertakings.

Where a SME decides to prepare consolidated financial statements, we believe that certain simplified procedures discussed under 'Section 18 – Business combinations and goodwill' below should also be made available.

Combined financial statements

As outlined in question 2, we do not recommend the inclusion of concepts that are not already incorporated in full IFRS unless clearly SME specific. The concept of combined financial statements has been introduced in the ED and we do not believe this is an issue that is only relevant to SMEs. In addition, if the requirements were to be maintained we do not believe there is currently sufficient guidance on how to prepare combined financial statements under the ED as it is unclear how fair value adjustments, equity eliminations etc would be performed.

Separate financial statements

The ED proposes to require in separate financial statements that all investments in subsidiaries, jointly controlled entities and associates are accounted for either at cost or fair value through profit or loss. Under full IFRS an entity may select a different accounting policy for each category of investments. We do not believe greater complexities or lack of comparability arises by allowing entities to determine a measurement bases for each category of investments and therefore believe this requirement should be similar to that under full IFRS.

Also as noted below under 'Section 11 - Financial assets and financial liabilities', we believe the ability to classify financial assets as available-for-sale should be retained.

Section 11 – Financial Assets and Financial Liabilities

We believe that significant progress has been made in simplifying the accounting for financial instruments. However, we believe there are areas within the ED that are now more complex or unclear than under full IFRS due to a lack of guidance and over-simplification of the requirements. Many organisations (both large and small) that have already adopted IAS 39 *Financial Instruments: Recognition and Measurement* had significant difficulties in applying the Standard and we do not believe that SMEs will have the skill base to implement complex financial instrument accounting. Furthermore, we do not believe users of financial statements will be interested in a complex approach.

Scope

In general, we believe the scope of Section 11 should be consistent with the scope of IAS 39. There are currently inconsistencies with respect to loan commitments, contingent consideration, share-based payments and reimbursements. We do not believe scoping these transactions, which many SMEs may undertake, into the ED as would appear to be the proposal, will reduce complexities for these entities. With such transactions within the scope of the ED, entities will be required to determine how to account for such transactions, which under full IFRS are outside scope and therefore in some cases accounted for under another Standard or potentially not directly accounted for at all, and therefore this may result in more onerous requirements than full IFRS reporters.

The scope exclusions with respect to leases, insurance contracts and non-financial contracts are currently different to full IFRS in what appears to be an attempt to bring into the ED transactions that under full IFRS would include embedded derivatives. Derivatives and embedded derivatives are not directly discussed anywhere in the ED and we believe that this will create confusion. For example, it would appear under paragraph 11.9 that non-closely related 'embedded derivatives' must be fair valued through profit and loss due to the limitations on qualification for amortised cost treatment. However this is not directly stated anywhere using the term derivative. Therefore, if this is the intention of the IASB, we believe this should be clearly stated in the proposed Standard. In addition, we believe the requirements become more onerous than for a full IFRS reporter. For example, a lease including an 'embedded derivative' would be accounted for in full under Section 11 as a financial asset/liability, whereas under IAS 39 only the embedded derivative would need to be fair valued as a derivative. We believe the concepts of operating and finance lease accounting are well understood and that this does not represent a simplification but will in fact complicate the accounting for preparers and users. We would support a requirement that does not scope into Section 11 of the ED contracts that include an 'embedded derivative' that would not otherwise already be in scope.

Hedge accounting

Overall we support the proposed simplification to hedge accounting unless IAS 39 is adopted in full. However we feel hedge accounting is not adequately explained in the ED. Section 11 includes little discussion around the actual accounting. For example, concepts such as how effectiveness should be determined, what is considered effective and how to account for ineffectiveness are not explained. Further guidance from IAS 39 should be included in the ED, with some simplifications incorporated, for example around short-cuts to effectiveness testing e.g. that applied in USGAAP.

The Basis for Conclusion, BC76(a), states:

"Hedge accounting cannot be achieved by using debt or equity instruments ('cash instruments') as hedging instruments. IAS 39 permits this for a hedge of a foreign currency risk. However, the same effect on profit or loss can be achieved by measuring the cash instrument at fair value, which Section 11 requires for some cash instruments and permits for others. SMEs typically sell the cash hedging instrument when the hedging relationship terminates."

We do not believe there is any benefit to SMEs in this simplification as the alternative accounting does not ultimately lead to the same effect on profit and loss. In designating a cash instrument at fair value through profit or loss it will not only be the foreign currency risk that will be revalued but all other risks, for example, credit and interest rate risk associated with the instrument. We believe such accounting is more onerous for SMEs and ultimately more costly as greater expertise will be required in order to perform such valuations.

Measurement

The ED allows certain financial instruments to be measured at cost or amortised cost. Neither cost nor amortised cost is defined in the ED and therefore it is unclear how initial transaction costs on acquisition should be accounted for. To avoid inconsistencies in treatment we suggest that further guidance on initial transaction costs is provided. In addition, a simplified method for allocating the initial transaction costs over the life of instrument may be to revert to the straight-line recognition in profit and loss method rather than through the effective yield method.

The elimination of the available-for-sale category for classification of financial assets, although eliminates an option, we do not believe that the requirements in IAS 39 are particularly complex and therefore believe SMEs should be able to classify financial assets as such, without reverting to full IAS 39. Forcing SMEs to fair value all such instruments through the profit and loss increases the volatility of performance.

Finally, the basis for conclusion, BC76(c), acknowledges that complexities are increased where there is a need to measure individual items at fair value. Section 13 *Investments in Associates* and Section 14 *Investments in Joint Ventures* provide an option to measure investments in associates and jointly controlled entities at cost. We question why such a similar exemption is not provided for all financial assets regardless of the level of influence/control unless the financial asset has a quoted marked price in an active market or is a derivative (unless over an unlisted equity instrument). This would represent a genuine simplification for SMEs. If not adopted, we would suggest that all financial assets and liabilities be measured at amortised cost unless they are specifically required by the Standard to be measured at fair value, that is, the determination is inverted, as we believe this will be more easily understood.

<u>Section 12 – Inventories</u>

The scope of Section 12 *Inventories* should be consistent with IAS 2 *Inventories*; therefore the exemption for work in progress arising under a construction contract should be included in this section of the ED. Even though construction contracts do not have their own SME section they are specifically addressed in Section 22 *Revenue*.

Refer also 'Section 26 – Impairment of non-financial assets – impairment of inventories' below regarding terminology changes.

Section 13 – Investments in Associates and Section 14 – Investments in Joint Ventures

We agree with the proposal in the ED to allow several options in accounting for investments in associates and joint venture entities. However, as noted above in 'Section 11 – Financial assets and financial liabilities' we believe the ability to classify financial assets as available-for-sale should be retained.

Section 16 – Property, Plant and Equipment

The requirements with respect to property, plant and equipment are currently largely consistent with full IFRS. We believe some simplifications should be introduced into the proposed Standard in order to better reflect the needs of SMEs. In particular, we would suggest with respect to:

- Componentisation of assets – given the complexities of complying with these requirements by full IFRS reporters we suggest that the requirements are optional, which may be achieved by including requirements similar to the previous requirements of IAS 16 *Property, Plant and Equipment*, effective periods beginning on or after 1 July 1999. This would therefore enable spare parts and servicing equipment to be recognised in the profit and loss as consumed where componentisation is performed at a larger unit of account than would be required by the current version of IAS 16, that is, a whole of asset basis
- Annual reviews – depreciation method, useful life and residual value reviews every year are onerous. By requiring regular, but not annual reviews we do not believe there would be a significant reduction in the usefulness of information available to users
- Land and buildings – in some jurisdictions significant cost and effort is required in order to split land and buildings into the two component parts. For example, investment property companies in South Africa assert that they are unable to obtain valuations of properties held in urban areas for rental and capital appreciation which value the land and buildings separately. We suggest that a simplification is provided in such circumstances to allow treatment as a single asset, but in such cases the entire asset should be subject to depreciation.

Finally, we suggest that the guidance included in IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* is included in the ED.

Section 18 – Business Combinations and Goodwill

Scope

As stated in question 2, we believe the scope of the ED should be consistent with full IFRS, therefore we believe Section 18 *Business Combinations and Goodwill* should include similar exemptions to those in IFRS 3 *Business Combination.* The IASB has yet to determine whether IFRS 3 principles are appropriate for transactions currently scoped out of IFRS 3. We understand that some of these transactions are being considered in the current exposure draft on proposed changes to IFRS 3, however, we do not believe that the IASB should pre-empt those changes for SMEs, but rather consider them as part of the maintenance project.

Accounting

We agree with the application of the purchase method of accounting for business combinations. However, given the difficulties many entities have in measuring the fair value of contingent liabilities we believe that paragraph 18.8 should be deleted and SMEs should only recognise contingent liabilities as they crystallise into liabilities. In relation to the allocation of the cost of a business combination, we would recommend including guidance on determining the fair values of the assets and liabilities acquired. Consideration should therefore be given to including paragraphs B16 and B17 from IFRS 3, Appendix B.

Another area where the fair value exercise is difficult for full IFRS reporters and therefore is likely to be more so for SMEs is intangible assets. We recommend the following simplifications for such assets:

- We recommend that a SME entity should be allowed, but not required, to separate out intangible assets from goodwill.
- In circumstances where significant intangibles assets are not separated out from goodwill, we recommend that goodwill be required to be amortised over a maximum period of 20 years.
- In circumstances where an entity elects to separate out significant identifiable intangible asset from goodwill we recommend that goodwill not be required to be amortised, rather it be assessment for impairment when there is an indicator of impairment. We would not require *all* identifiable intangible assets to be separated out from goodwill for this recommendation to apply.

We would recommend applying the above simplification on an individual business combination basis, rather than as an accounting policy choice.

Areas where we believe further guidance is required in accounting for business combinations include:

- Reverse acquisitions – Reverse acquisitions are suggested by paragraph 18.9 but then are not addressed sufficiently in the ED. We would suggest that more guidance in identifying and accounting for reverse acquisitions is given in the IFRS for SMEs where an option/requirement to consolidate is maintained.
- Cost of a business combination – Only the bold paragraph from IFRS 3 on determining the cost of a business combination has been included in the ED. Some critical interpretive material has been omitted. We would suggest including guidance on deferred settlement and determining the fair value of equity instruments granted.
- Accounting for business combinations achieved in stages – Without guidance in this area we believe comparability will not be achieved given the various methods used under full IFRS to account for step acquisitions post-control being achieved. Also, given the specific requirements in Section 9 *Consolidated and Separate Financial Statements* for accounting for changes in minority interests, similar conclusions may not be reached by analogy.
- Initial accounting determined provisionally – SMEs will very likely undertake transactions where the cost of the business combination is contingent on future events, for example, profit warranties. We suggest further guidance is included around such accounting and we would also encourage the simplification of the guidance e.g. adjustments are made on a prospective basis hence comparative information is therefore not restated.

<u>Section 19 – Leases</u>

Please refer to our comments under 'Section 11 – Financial assets and financial liabilities – scope' above with respect to the determination of which section of the ED accounting for certain leases which contain 'embedded derivatives' should be scoped in to.

Classification of leases

We believe further guidance should be provided on the classification of leases of land and buildings. Such leases are likely to be undertaken by SMEs and in the past related issues have been referred to IFRIC for consideration, which indicates confusion amongst preparers. Further, as noted previously, significant cost and effort is required to split land and buildings in some jurisdictions, therefore, we would recommend simplification of these requirements such that there is an option, but no requirement, to split leases of land and buildings into their component parts.

Financial statements of lessees – finance leases

Paragraph 19.8 requires the initial recognition of a financial lease asset and liability at the fair value of the leased item determined at the inception of the lease. We would recommend that the alternative method within IAS 17 *Leases* of determining the value of the financial lease as the present value of the minimum lease payments be adopted for SMEs as an option as the fair value of the item may not always be known without additional costs being incurred. However, we would propose that SMEs be permitted to use their own incremental borrowing rate, rather than the rate implicit in the lease, as the discount rate in determining the present value of the minimum lease payments. We believe such an option should be able to be applied on a lease by lease basis and would reduce the complexity involved in accounting for leases without significantly undermining the quality of the financial information provided.

In addition, with respect to subsequent measurement, paragraph 19.10 allows an entity to use an approximation to simplify the calculation of finance charges for a period arising on a finance lease. The terms 'approximation' and 'simplify' are not defined within the ED and are likely to be interpreted differently. We believe the determination of whether an approximation approach is appropriate is an audit issue which should not be addressed by an accounting standard.

Financial statements of lessees – operating leases

We recommend the simplification of accounting for operating leases by eliminating the straight lining of lease payments based on a time basis and instead referring to the 'economic benefits to be derived from the leased asset'. Such a method may allow entities to book lease expense as lease payments occur (for example, lease payments linked to annual fixed inflators as a proxy for inflation) and therefore is in line with how an entity sees the lease expense occurring and eliminates the 'straight-line' calculation.

Financial statements of lessors

We do not agree with paragraph BC62 of the Basis for Conclusions that SMEs are unlikely to be finance lessors. A finance lessor is not always likely to be publicly accountable as an entity may undertake this only as a small part of their business, and may be common in related party scenarios. We would recommend that the accounting for finance lessors from IAS 17 *Leases* should be simplified and included in the proposed Standard.

Section 20 – Provisions and Contingencies

Examples of provisions for restructuring and onerous contracts are included at paragraphs 20A.2 and 20A.3 of the ED. However Section 20 *Provisions and Contingencies* does not address such provisions in detail, as included in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. As such the examples could be seen to be inconsistent with the general principles. We suggest further guidance is included in the ED to clarify these requirements.

Section 21 – Equity

Section 21 *Equity* in the ED introduces several new requirements on issues which are not addressed by full IFRS. As stated in question 2, we do not think this is appropriate and it is difficult to assess the appropriateness of the accounting when alternative methods have not been analysed by the IASB.

Original issue of shares or other equity instruments

Paragraph 21.2 introduces a number of concepts into IFRS for SMEs that are not covered by full IFRS, in particular, the accounting for partly paid shares and similar instruments. Under full IFRS we believe there is divergent treatment being adopted in this area. Some entities are not recognising the 'right to receive' at all in the balance sheet until amounts are called and the cash is received on the basis that IAS 32 *Financial Instruments: Presentation*, illustrative example, IE10, notes that a forward to sell equity that will be settled with the gross exchange of shares for a fixed amount of cash should be recognised as equity only when the cash is paid. Alternatively, the amount is being recognised as a receivable at both discounted (based on an expectation of when the amount will be called) and undiscounted (as the amount is at call) amounts with a corresponding increase in equity. Therefore, given the various alternatives that currently exist under full IFRS we believe it is unfair to limit the choice for SMEs without further debate. In addition, we believe this is an area which may cause confusion globally due to terminology differing between jurisdictions with respect to the type, issue and call of equity instruments.

Also in respect of the issue of shares, we believe the requirements of paragraph 21.3 may be inconsistent with the accounting for common control transactions where fair value accounting is not always applied due to the scope exclusion in IFRS 3[2]. Therefore we suggest that an equivalent scope exclusion be included in this paragraph.

Minority interest and transactions in shares of a consolidated subsidiary

Paragraph 21.11 introduces specific accounting for changes in the parent's controlled interest: that is, treating any change in ownership that does not result in a loss of control of a subsidiary as a transaction with equity holders. We are aware of five or six different methods which are currently being applied under full IFRS. It is unclear whether this requirement is being proposed on the basis of it being the 'right' treatment, or as a simplification. If it is the former, then the issue of the applicability of the treatment under full IFRS then arises, as discussed further in question 4.

[2] Note, at the July 2007 IASB meeting the IASB directed the staff to draft an amendment to IAS 27 *Consolidated and Separate Financial Statements* to clarify that IAS 27.37 does not apply to the formation of a new parent entity for an existing group where there is no change in structure resulting from the revised organisation structure (a form of a common control transaction) and that such reorganisations should be accounted for by reference to existing carrying amounts.

Issuance of compound financial instruments

We do not believe that the requirement to split a compound financial instrument into its component parts provides useful information to users of SME financial statements, as this exercise merely provides a conceptual split which does not bear a direct relation to the entity's cash flows. We believe that where a SME has a financial instrument outstanding which would otherwise be required to be accounted for as a compound financial instrument in accordance with requirements consistent with IAS 32 the entity should be permitted either to account for the instrument in accordance with these requirements, or to account for the entire instrument as a liability.

Due to the potential differences in nature of each financial instrument that an entity may issue, we would recommend that an entity is allowed an accounting policy option for compound financial instruments on an item by item basis.

<u>Section 23 – Government Grants</u>

Accounting for government grants is an issue not limited to SMEs. We would encourage the IASB to review the requirements of existing IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* before proposing any changes to the accounting for government grants. It is widely acknowledged that there are issues in applying IAS 20 and this should be addressed directly by the IASB.

While we acknowledge that the changes made to accounting for government grants achieve consistency they do not necessarily make it easier to account for government grants. Rather the requirements are just different. Therefore, implying that the changes made to accounting for government grants for SMEs is a 'simplification' where they are untried and untested is questionable.

The proposed requirements, where there are performance conditions attaching to the grant (which is often the case) which are not met, require the deferral of government grant revenue. If the proposed requirements are maintained, we suggest further guidance is included that is consistent with the guidance in IAS 41 *Agriculture*, on the basis that the intention of the IASB (BC115) was to make the ED consistent. Currently we think the timing of recognition may be interpreted differently.

Finally, we believe the requirements of SIC 10 *Government Assistance – No Specific Relation to Operating Activities* should also be incorporated into the ED.

<u>Section 25 – Share-based Payment</u>

Equity-settled share-based payment transactions

Given the complexity and cost of IFRS 2 valuations and the little benefit that a SME will derive, we do not think equity-settled share-based payments to employees should be recognised as an expense but instead the requirements should be only for some disclosures around such employee share-based payments. Fair value disclosures should not be required. The requisite disclosures should describe the principal terms and conditions of any equity-settled share-based payment transactions that exist during the period including, the number of shares and the number of employees involved, the grant date, any vesting conditions and over what period these apply, the maximum term of the option granted and, where applicable, any option exercise price. We believe these disclosures would provide the information that users need, that is, information about the consumption of resources by the entity that are not all reflected in the income statement, and the extent to which the supplementary consumption of resources potentially dilute shareholdings. We would propose that IFRIC 11 type share-based payments are excluded from such disclosure.

We believe that equity-settled share-based payments to third parties in exchange for goods and services should be continued to be accounted for in accordance with IFRS 2, that is, expensed at grant date fair value through profit or loss over any vesting period as appropriate, as those arrangements can be readily fair valued by reference to the fair value of goods or services received.

However, if the IASB decides to maintain the proposals in the ED, we believe more guidance should be included. As per question 1 we believe the ED should be a stand-alone document. As the ED currently stands there would be issues around the scope of the section and applicability of IFRIC Interpretations with respect to share-based payments given the differences between the proposed IFRS for SMEs and full IFRS.

Cash-settled share-based payment transactions

We agree that cash-settled share-based payments should be measured and recognised. However, requiring recognition and measurement at fair value may be a costly and difficult exercise for SMEs as indicated above. We therefore propose that cash-settled share-based payments be measured at the best estimate of the cash payable (with reference to the service provided to date) or intrinsic value.

<u>Section 26 – Impairment of Non-Financial Assets</u>

Impairment of inventories

One of the intentions of the ED is to simplify accounting by SMEs. We believe that changing the terminology with respect to the impairment of inventories from ‘net realisable value’ to ‘selling price less costs to complete and sell’ may be confusing and therefore suggest the term 'net realisable value' continues to be used. If the IASB believe that the term 'selling price less costs to complete and sell' is a superior term then we suggest that an amendment is made to IAS 2 *Inventories* before any change is made to the proposed Standard.

Impairment of non-financial assets other than inventories

The ED includes only one basis of determining recoverable amount, being fair value less costs to sell. It is unclear why the value-in-use model has not been maintained in the ED. We believe that by effectively forcing a fair value model on SMEs the requirements are more onerous than the existing requirements of IAS 36 *Impairment of Assets*. Entities are more likely to be able to perform a value-in-use calculation independently whereas a fair value calculation may require the cost of an external valuer.

In addition, we believe the basis for the inclusion of both a value-in-use and fair value less costs to sell model in IAS 36 is equally applicable for SMEs. By including only one method a SME may be required to write-down assets that it wouldn’t otherwise be required to. A simplified value-in-use methodology may be appropriate which might include a simple valuation method to assist SMEs in determining whether a detailed impairment test is required and/or the ability for SMEs to use their own incremental borrowing rate as the discount rate.

<u>Section 27 – Employee Benefits</u>

Although IFRS for SMEs covers the principles on how to account for employee benefits, a lot of the very useful explanatory paragraphs have been omitted. Given the complexity in accounting, particularly for defined benefit plans, it may be advisable to add some of these paragraphs to IFRS for SMEs (for example, the guidance in IAS 19 paragraphs 49, 50, 52, 58, 58A, and 61). We appreciate that this increases the volume of guidance; however, the improvements in understandability counteract that.

Defined benefit plans

We agree with the IASB that defined benefit plans are common in some jurisdictions and therefore the ED needs to specifically cover such transactions. In order to achieve good communication with users of the SME financial statements we do not believe there should be significant differences introduced between full IFRS and IFRS for SMEs. We believe the ED should specifically include further guidance with respect to an asset limit. Consistent with IAS 19 *Employee Benefits*, to avoid profit or loss volatility the ability to recognise actuarial gains and losses outside profit or loss should be permitted.

If the Board does not adopt the amendment to IAS 1 in respect of the reporting owner changes in equity and comprehensive income for SMEs then we believe that the IFRS for SMEs should permit, but not require, SMEs to recognise actuarial gains and losses outside of profit or loss provided that the entity presents a statement of changes in equity that excludes ownership transactions with equity holders.

Section 28 – Income Taxes

We agree with the IASB that some form of deferred taxes should be recognised by SMEs, however we do not believe that the 'timing differences plus' approach represents a simplification for SMEs. In fact, we are concerned that the proposed simplifications may be much more onerous to apply than intended.

The IASB has incorporated into the ED requirements based on where the IAS 12 *Income Taxes* project appears to be going, for example, with respect to the initial recognition exemption and the investments exemption. Until such requirements are finalised we do not believe they should be incorporated into the ED as we believe inconsistencies will be created with other parts of the ED. For example, if deferred tax arises on an item of property, plant and equipment on initial recognition that is initially measured at cost under paragraph 16.6, the requirements of paragraph 28.17 that the carrying amount of the asset at initial recognition should equal the fair value the asset would have had if its tax base and fair value were equal, are currently inconsistent. In addition, the initial recognition requirements are introducing another definition of fair value which we believe will be confusing for users and preparers.

Also by removing most of the exceptions for investments, and introducing a specific exemption for foreign subsidiaries, branches, associates and joint ventures, increased judgement will be required in the preparation of financial statements, due to the requirement to assess for a deferred tax liability the probability of reversal for all investment types, rather than having the control test in existing IAS 12, thus increasing the complexity for SMEs.

By explaining the temporary differences approach through the use of timing differences terminology the IASB appears to acknowledging that the temporary differences approach is burdensome and difficult to understand. (This, however, is further confused due to the introduction of new terms such as 'inside basis differences' and 'outside basis differences'.) We think given the above issues and the complexities with the temporary differences approach that a simplified method based on a timing differences approach would be appropriate and would create real cost and time benefits for SMEs.

Section 29 – Financial Reporting in Hyperinflationary Economies

Guidance on how to account for hyperinflation needs to be included in the IFRS for SMEs. Hyperinflation is a question of location rather than a question of size. If a hyperinflationary country adopted IFRS for SMEs (and not full IFRS) we believe reference to full IFRS would be confusing. Relevant extracts from IAS 29 *Financial Reports in Hyperinflationary Economies* and IAS 21 *The Effects of Changes in Foreign Exchange Rates* need to be simplified and included within the proposed Standard.

Section 30 – Foreign Currency Translation

Functional currency

A paragraph similar to IAS 21.12 should be included to indicate the hierarchy for considering indicators of functional currency.

Disposal of a foreign operation

The requirement in paragraph 30.24 to recycle cumulative exchange differences deferred in equity into profit and loss when the gain or loss on disposal of a foreign operation is recognised imposes a significant administrative burden on entities to track historical exchange differences. We believe SMEs should not be permitted to recycle these foreign exchange differences.

Section 31 – Segment Reporting

Refer question 6 for comments regarding this section.

Section 33 – Related Party Disclosures

As indicated in question 9, we believe disclosures can be significantly simplified for SMEs and that related party disclosures are not within the key disclosures required. However, if related party disclosures are maintained, we propose that where consolidated financial statements are prepared an exemption from the requirements of IAS 24 paragraph 17 should be allowed for transactions with the following related parties:

- the parent;
- entities with joint control or significant influence over the entity;
- subsidiaries;
- associates; and
- joint ventures in which the entity is a venturer.

Section 34 – Earnings per Share

Refer question 6 for comments regarding this section.

Section 35 – Specialised Industries - Agriculture

We do not believe that the fair value method of accounting for biological assets and agricultural produce at point of harvest should be required in IFRS for SMEs. We believe that determining fair value, and point of sale costs, are costly and time consuming tasks and unnecessary to this type of preparer. Accordingly we believe biological assets should be measured at their cost, less accumulated depreciation and impairment losses. Extra guidance would be required though with respect to cost, for example, cost related to biological transformation and internally generating intangible assets.

However, if the proposed model is maintained, further guidance is required as to when the fair value is '*reliably determinable without undue cost or effort*'. IAS 41 *Agriculture* currently includes a rebuttable presumption that fair value can be reliably measured. Therefore it is unclear whether the ED is attempting to set in place a lower hurdle than IAS 41. This should be clarified, as we otherwise believe different interpretations of the term may otherwise arise.

We suggest that following principle be followed which will clarify our concerns above while still achieving the intended outcome.

> *The entity shall apply the cost model to account for biological assets unless there is evidence that the fair value of the biological assets can be reliably obtainable on a continuing basis.*

<u>Section 36 – Discontinued Operations and Assets Held for Sale</u>

Very little guidance has been included in IFRS for SME on discontinued operations and assets held for sale.

Some important parts of IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* in relation to discontinued operations have been omitted (e.g. recognition of impairment losses and reversals) and we believe in a stand-alone document more guidance should be provided.

We believe that a simplified approach could be applied to SMEs in relation to assets held for sale, that unless a binding sale agreement has been obtained, no reclassification should be permitted.

Appendix C

The following cross references to full IFRS exist in the ED. We have analysed each of these with our proposed suggestion as to whether a cross-reference is needed and if not whether any guidance should be given.

#	ED	IFRS	Description	BC	Cross reference
1	7.9	IAS 7	Option to use direct method for cash flows from operating activities under IAS 7	114	No cross-reference Include simplified guidance in ED
2	11.1	IAS 39/ IFRS 7	Option to follow IAS 39 in full for financial instruments and hence must also follow disclosures in IFRS 7 (also definition of hedging instrument refers back to IAS 39)	78	Cross reference where enitiies elect to apply the requirements of IAS 39 *Financial Instruments: Recognition and Measurement* Where IAS 39 is not applied, include simplified guidance in ED
3	13.5	IAS 28	Option to follow equity method and disclosures for associates under IAS 28	83	No cross-reference Include simplified guidance in ED
4	14.10	IAS 28/ IAS 31	Option to follow equity method and disclosures for jointly controlled entities under IAS 28 (via IAS 31)	83	No cross-reference Include simplified guidance in ED
5	14.11	IAS 31	Option to follow proportionate consolidation method and disclosures for jointly controlled entities under IAS 31	83	No cross-reference Include simplified guidance in ED
6	15.5	IAS 40	Option to follow fair value model and disclosures for investment property under IAS 40	110	No cross-reference Include simplified guidance in ED
7	16.13	IAS 16	Option to follow revaluation model and disclosures for property, plant and equipment under IAS 16	111	No cross-reference Include simplified guidance in ED
8	17.16	IAS 38	Option to follow capitalisation model for research and development under IAS 38	82	No cross-reference Include simplified guidance in ED
9	17.23	IAS 38	Option to follow revaluation model and disclosures for intangible assets under IAS 38	112	No cross-reference Include simplified guidance in ED
10	19.15	IAS 17	Omitted guidance - lessor in a finance lease refers to guidance and disclosures under IAS 17	62	No cross-reference Include simplified guidance in ED
11	23.3(a)	IAS 20	Option to use IAS 20 for government grants which are not related to assets measured at fair value	115	No cross-reference Include simplified guidance in ED

#	ED	IFRS	Description	BC	Cross reference
			through profit or loss		
12	24.4, 24.5	IAS 23	Option to use capitalisation model and disclosures for borrowing costs under IAS 23	113	No cross-reference Include simplified guidance in ED
13	25.4	IFRS 2	Omitted guidance - for equity-settled share-based payments refer to measurement and disclosures under IFRS 2	59	No cross-reference Include simplified guidance in ED
14	25.7	IFRS 2	Omitted guidance - for share-based payment transactions with cash alternatives refer to guidance under IFRS 2	n/a	No cross-reference Include simplified guidance in ED
15	29.2/ 30.21	IAS 29	Omitted guidance - entities whose functional currency is hyperinflationary follow IAS 29 in full and related part of IAS 21	58	No cross-reference Include simplified guidance in ED
16	31.1	IFRS 8	Omitted guidance - entities wishing to produce segment information refer to IFRS 8	64	No cross-reference
17	34.1	IAS 33	Omitted guidance - entities wishing to produce earnings per share refer to IAS 33	63	No cross-reference
18	35.1(a)	IAS 41	Omitted guidance - entities with biological asses whose fair value is readily determinable without due cost and effort apply fair value model and give disclosures under IAS 41	60	No cross-reference Include simplified guidance in ED
19	35.3	IFRS 4	Omitted guidance - entities who are insurers are outside scope of IFRS for SMEs	65	No cross-reference
20	37.1	IAS 34	Option to follow IAS 34 for interim financial statements	61	No cross-reference