4 February 2014

Our ref: ICAEW Rep 21/14

Your ref: ED/2013/9

Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Hans

ED/2013/9 *Proposed amendments to the IFRS for SMEs*

ICAEW is pleased to respond to your request for comments on ED/2013/9 *Proposed amendments to the IFRS for SMEs.*

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

Yours sincerely

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ICAEW REP 21/14

ICAEW REPRESENTATION

ED/2013/9 PROPOSED AMENDMENTS TO THE IFRS FOR SMES

Memorandum of comment submitted in February 2014 by ICAEW, in response to IASB's exposure draft ED/2013/9 *Proposed amendments to the IFRS for SMEs* published in October 2013.

Contents	**Paragraph**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the exposure draft ED/2013/9 *Proposed amendments to the IFRS for SMEs* published by the IASB on 3 October 2013, a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

MAJOR POINTS

We generally welcome the proposed changes but the board could have gone further

5. While we agree with the majority of the proposed changes, we believe that additional improvements to the standard could have been made if the board had accepted some of the points raised by us and others in response to their earlier request for information. The SMEIG agreed with a number of these points and made several sensible recommendations which, disappointingly, the board have chosen not to take forward.

6. While there is little point in rehearsing these issues in full, we would like to take this opportunity to express our concern about the board's willingness to ignore the recommendations of the SMEIG. We accept that the SMEIG is only an advisory body and that the board is, of course, at liberty to reach its own conclusions but nonetheless we feel that good due process should entail the board, at a minimum, explaining why it has decided not to follow the advice given to it. Simply stating in the basis for conclusion that 'in the majority of cases the decisions of the IASB were consistent with the suggestions made by the SMEIG' does not suffice.

Clearer principles are needed for dealing with new and revised IFRSs

7. Paragraphs BC 29-32 purport to set out the board's principles for determining if and when new and revised standards should be 'incorporated' into the IFRS for SMEs. While we agree that decisions should be made on a 'case-by-case' basis, we believe that the board should explicitly set out the criteria against which their assessment will be made.

8. In the absence of such criteria, constituents will have no clear idea of whether or not a new or revised standard will be 'incorporated' into the IFRS for SMEs. For example, it is impossible to ascertain whether the board will change section 12 of the IFRS for SMEs to reflect IFRS 9's revised hedging requirements by reviewing the so-called 'principles' contained in the basis for conclusions.

9. It is therefore, perhaps, unsurprising that the board's decisions on whether or not to 'incorporate' new and revised standards into the IFRS for SMEs as part of this review appear somewhat haphazard. In our view some changes that would improve or simplify the IFRS for SMEs have been ignored (eg, the recent amendments to the basis of the calculation of net interest under IAS 19) while others of relatively limited value have been 'incorporated' into the standard (eg, the recent amendments to IAS 1).

10. We therefore urge the board to reconsider and to set out a clearer set of principles for determining whether the IFRS for SMEs should be amended in light of a new or revised standard being published. In our response to the request for information, we suggested creating a hierarchy of objectives – such as simplicity, understandability and comparability with full IFRS – against which the IASB could assess whether or not changes should be 'incorporated' into the IFRS for SMEs. We also suggested a rebuttable presumption that amendments should not be made to the IFRS for SMEs if they conflicted with these principles. We continue to believe that an approach along these lines would be more transparent and appropriate.

Resist any temptation to include additional options

11. The board will no doubt once again receive some comment letters encouraging the introduction of additional options. We are aware that some constituents would like the board to allow, for example, the option of revaluing property, plant and equipment or the option of capitalising development and/or borrowing costs. While we appreciate the arguments in favour of introducing such options – and indeed in the past we have to some extent championed their inclusion – we now feel that, on balance, it is best to keep the standard as simple as possible as if individual jurisdictions wish to introduce additional options, they are free to do so (although entities applying that standard could not then, of course, claim compliance with the IFRS for SMEs).

12. Indeed, the UK has recently adopted this approach when developing a new version of its domestic GAAP that is based upon – but not fully aligned with – the IFRS for SMEs. While we supported these amendments as being appropriate in a UK context, we realise that they would not be desirable for all jurisdictions, many of which would have no interest in using them and would regard them as unnecessary complications. A simple, core standard that individual jurisdictions can adopt wholesale or build upon as desired is, we believe, the ideal outcome.

Undue cost or effort is ill-defined

13. Paragraphs BC 74-75 talk about the addition of two 'undue cost or effort' exemptions. However, the exposure draft actually adds four such exemptions to the standard – not only in relation to measuring investments in equity instruments at fair value and recognising intangible assets of the acquiree separately in a business combination but also in relation to extinguishing financial liabilities with equity instruments (paragraph 22.15A) and offsetting income tax assets and liabilities (paragraph 29.29).

14. Given the increasingly frequent occurrence of such exemptions in the IFRS for SMEs, it is sensible for the board to include additional guidance explaining what it means by 'undue cost or effort'. However, the guidance added at paragraphs 2.14A-C is unclear and is not particularly helpful as there is insufficient detail to enable entities to assess the balance between costs and benefits or to help auditors assess whether or not an entity is entitled to apply an exemption.

15. Moreover, we are unclear whether any material items would ever pass the 'undue cost or effort' test as we would expect that, if an item is material, then the decisions of the expected users of the financial statements would be affected by the availability or otherwise of information about it.

Basic and other financial instruments

16. As the UK prepares to adopt FRS 102 *The Financial Reporting Standard Applicable in the UK and Republic of Ireland* – a new standard that is largely based upon the IFRS for SMEs – it has become apparent that strict application of the requirements of section 11 of the IFRS for SMEs will often result in debt instruments that many would consider to be 'basic' being classified as 'other'. For example, it appears that debt instruments with interest rate caps or floors or with stepped interest rates or prepayment provisions would in many cases fail to qualify as basic. Consequently many relatively straightforward instruments will need to be measured at fair value under the IFRS for SMEs, even though in many instances the same instruments would be measured at amortised cost under full IFRS. This outcome places a disproportionate cost burden on SMEs, which we believe is a wholly unsatisfactory outcome.

17. This issue stems from the requirements of paragraph 11.9 of the IFRS for SMEs which are very restrictive, meaning that the line between basic and other instruments seems to have been drawn in an inappropriate place. The UK's Financial Reporting Council is currently undertaking a project to redraw that line in what it sees as a more appropriate place ie, in a way that ensures that commonly-occurring, simple financial instruments are measured at amortised cost whenever they are treated that way under full IFRS. It will shortly issue an exposure draft on the subject. We urge the board to follow this consultation closely and to consider making similar changes to the IFRS for SMEs.

The three year review cycle should be retained

18. While we acknowledge that many small and medium-sized entities appreciate stability, we feel that this is adequately provided for by the existing three year review cycle and that this should therefore be retained rather than extended to five years.

RESPONSES TO SPECIFIC QUESTIONS

Question 1 – Definition of 'fiduciary capacity'

The IASB has received feedback that the meaning of 'fiduciary capacity' in the definition of 'public accountability' (see paragraph 1.3(b) of the IFRS for SMEs) is unclear as it is a term with different implications across jurisdictions. However, respondents generally did not suggest alternative ways of describing public accountability or indicate what guidance would help to clarify the meaning of 'fiduciary capacity'. Based on the outreach activities to date, the IASB has determined that the use of this term does not appear to create significant uncertainty or diversity in practice.

(a) Are you aware of circumstances where the use of the term 'fiduciary capacity' has created uncertainty or diversity in practice? If so, please provide details.
(b) Does the term 'fiduciary capacity' need to be clarified or replaced? Why or why not? If you think it needs to be clarified or replaced, what changes do you propose and why?

19. We have not come across any uncertainty or diversity in practice as 'fiduciary capacity' is not used as test of 'public accountability' in the UK.

20. However, when the UK's Financial Reporting Council was consulting on the new UK GAAP – which is based upon the IFRS for SMEs – the definition of 'public accountability' generated a lot of debate. This, in part, related to the meaning of 'fiduciary capacity' with some concerns being raised as to whether the current definition would capture all entities that it intended to eg, some felt that banks and/or building societies would not be covered by the existing definition. This ultimately contributed to the Financial Reporting Council's decision not to use public accountability when defining the scope of the new UK standard.

21. Rather than amend the standard, it may be better to leave it to individual jurisdictions to provide any necessary clarification when permitting or requiring use of the IFRS for SMEs.

Question 2 – Accounting for income tax

The proposal to align the main principles of Section 29 Income Tax with IAS 12 *Income Taxes* for the recognition and measurement of deferred tax (see amendment number 44 in the list of proposed amendments at the beginning of this Exposure Draft) is the most significant change being proposed to the IFRS for SMEs.

When the IFRS for SMEs was issued in 2009, Section 29 was based on the IASB's Exposure Draft *Income Tax* (the '2009 ED'), which was issued in March 2009. However, the 2009 ED was never finalised by the IASB. Consequently, the IASB has concluded that it is better to base Section 29 on IAS 12. The IASB proposes to align the recognition and measurement principles in Section 29 with IAS 12 (see paragraphs BC55–BC60) whilst retaining some of the presentation and disclosure simplifications from the original version of Section 29.

The IASB continues to support its reasoning for not permitting the 'taxes payable' approach as set out in paragraph BC145 of the IFRS for SMEs that was issued in 2009. However, while the IASB believes that the principle of recognising deferred tax assets and liabilities is appropriate for SMEs, it would like feedback on whether Section 29 (revised) can currently be applied (operationalised) by SMEs, or whether further simplifications or guidance should be considered.

A 'clean' version of Section 29 (revised) with the proposed changes to Section 29 already incorporated is set out in the appendix at the end of this Exposure Draft.

Are the proposed changes to Section 29 appropriate for SMEs and users of their financial statements? If not, what modifications, for example further simplifications or additional guidance, do you propose and why?

22. As section 29 is based on proposals that were aborted before they came to fruition, it clearly needs to be replaced. While IAS 12 is not popular in practice and there have been repeated calls for its replacement, it makes sense at the present time for the related requirements in the IFRS for SMEs to be based upon it.

23. We are satisfied that the revised section 29 – which is a simplified version of IAS 12 – is appropriate for SMEs and users of their financial statements. However, the board could perhaps have simplified things even further. With this in mind, we suggest that the board consider the equivalent section of the new UK standard – FRS 102 – that provides a simpler solution that nonetheless remains largely consistent with IAS 12.

24. Doubtless, some will continue to argue that flow-through or the liability method would be more appropriate for SMEs. Indeed some of our own committee members continue to champion these methods. However, on balance, we do not support either approach as – although relatively simple – their introduction would not only lead to, in many cases, an understatement of deferred tax liabilities but would also reduce comparability between full IFRSs and the IFRS for SMEs.

25. We do not have any suggested modifications to the redrafted section 29.

Question 3 – Other proposed amendments to the IFRS for SMEs

The IASB proposes to make a number of other amendments to the IFRS for SMEs. The proposed amendments are listed and numbered 1–43 and 45–57 in the list of proposed amendments. Most of those amendments are minor and/or clarify existing requirements.
(a) Are there any amendments that you do not agree with or have comments on?
(b) Do any of the amendments require additional guidance or disclosure requirements to be added to the IFRS for SMEs? If so, which ones and what are your suggestions?

If you disagree with an amendment please state any alternatives you propose and give your reasoning.

26. We agree with the majority of the proposed amendments. However we have some concerns about the following:

a) Undue cost or effort – paragraphs 2.14A-C

27. Given the increasingly frequent occurrence of such exemptions in the IFRS for SMEs, it is sensible for the board to include additional guidance explaining what it means by ‘undue cost or effort’. However, the guidance added at paragraphs 2.14A-C is unclear and is not particularly helpful as there is insufficient detail to enable entities to assess the balance between costs and benefits or to help auditors assess whether or not an entity is entitled to apply an exemption. Moreover, we are unclear whether any material items would ever pass the ‘undue cost or effort’ test as we would expect that, if an item is material, then the decisions of the expected users of the financial statements would be affected by the availability or otherwise of information about it.

28. The existing wording in paragraph 2.13 of the IFRS for SMEs deals with the balance between costs and benefits. Linking this directly to the ‘undue cost or effort’ criteria would be helpful. For example, it would add clarity if the board could make it clear that ‘obtaining information involves undue cost or effort if the benefits derived from that information are exceeded by the costs of providing it’.

29. As a further control, we believe that entities should be required to make appropriate disclosure if they have applied any of the standard’s ‘undue cost or effort’ exemptions, including their reasons for doing so.

b) Uniform reporting dates – paragraph 9.16

30. The proposed amendment is an improvement on the current requirements as it provides guidance on what should be done when it is impracticable for the parent to obtain financial statements for all of its subsidiaries at the same reporting date.

31. We are, however, concerned that the proposed amendment introduces too much flexibility by allowing the parent to use simply the ‘most recent’ financial statements of the subsidiary, as these could be from the previous year or, in some cases, a number of years ago.

32. We therefore recommend that paragraph 9.16 be redrafted to state that – consistent with paragraph B93 of IFRS 10 – the difference between the date of the subsidiary’s financial statements and that of the consolidated financial statements shall not be more than three months before or after the date of the consolidated financial statements and that there should be consistency from period to period. If this is considered too stringent, an alternative would be to state that the year end of the subsidiary should at least fall within the parent’s financial year.

c) Classification of an instrument as liability or equity – paragraph 22.3A

33. We welcome the additional guidance on classifying financial instruments as equity or liabilities. However, additional clarification regarding contingent settlement provisions is also needed to ensure that all instruments are classified appropriately. For example, it should be made clear that an instrument should be classified as equity if the issuer can be required to settle the obligation in cash or another financial asset only in the event of the liquidation of the issuer or when the contingent settlement provision is not considered genuine.

34. Paragraph 22.3A refers to classification being based on 'substance rather than legal form' whereas it would be more appropriate to echo the wording of paragraph 2.8 of the IFRS for SMEs ie, 'in accordance with their substance and not merely their legal form'.

d) Extractive activities – paragraph 34.11

35. The proposed amendment seeks to clarify the accounting requirements for extractive industries by cross-referring to paragraphs 10.4-10.6. In our view, this revised wording would still not permit the recognition of exploration and evaluation assets under the IFRS for SMEs.

36. In extractive industries, at the exploration and evaluation stage, it is not known whether it is probable that economic benefits will flow to the entity from these activities. As a result, the criteria (set out in paragraph 2.27 of the IFRS for SMEs) for the recognition of an asset are not met. IFRS 6 *Exploration for and Evaluation of Mineral Resources* recognises this issue, and resolves it by allowing a temporary exemption from the relevant paragraphs of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (see IAS 8 paragraphs 11 & 12 and IFRS 6 paragraph 7).

37. In our view, it would be better either to allow a similar temporary exemption from paragraphs 10.5 & 10.6 of the IFRS for SMEs for exploration and evaluation assets or to state that entities using the IFRS for SMEs that are engaged in extractive industries should apply the requirements of IFRS 6.

Question 4 – Additional issues

In June 2012 the IASB issued a Request for Information (RfI) seeking public comment on whether there is a need to make any amendments to the IFRS for SMEs (see paragraphs BC2–BC15). The RfI noted a number of specific issues that had been previously identified and asked respondents whether the issues warranted changes to the IFRS for SMEs. Additionally, the RfI asked respondents to identify any additional issues that needed to be addressed during the review process. Any issues so identified were discussed by the IASB during its deliberations.

Do respondents have any further issues that are not addressed by the 57 amendments in the list of proposed amendments that they think the IASB should consider during this comprehensive review of the IFRS for SMEs? Please state these issues, if any, and give your reasoning.

38. The proposals do not raise many additional issues beyond those that we raised in our response to the board's request for information. We therefore refer you the contents of that letter. We do, however, have a few additional points, as follows:

a) Basic and other financial instruments

39. As the UK prepares to adopt FRS 102 *The Financial Reporting Standard Applicable in the UK and Republic of Ireland* – a new standard that is largely based upon the IFRS for SMEs – it has become apparent that strict application of the requirements of section 11 of the IFRS for SMEs will often result in debt instruments that many would consider to be 'basic' being classified as 'other'. For example, it appears that debt instruments with interest rate caps or floors or with stepped interest rates or prepayment provisions would in many cases fail to qualify as basic. Consequently many relatively straightforward instruments will need to be measured at fair value under the IFRS for SMEs, even though in many instances the same instruments would be measured at amortised cost under full IFRS. This outcome places a disproportionate cost burden on SMEs, which we believe is a wholly unsatisfactory outcome.

40. This issue stems from the requirements of paragraph 11.9 of the IFRS for SMEs which are very restrictive, meaning that the line between basic and other instruments seems to have been drawn in an inappropriate place. The UK's Financial Reporting Council is currently undertaking a project to redraw that line in what it sees as a more appropriate place ie, in a way that ensures that commonly-occurring, simple financial instruments are measured at amortised cost whenever they are treated that way under full IFRS. It will shortly issue an exposure draft on the subject. We urge the board to follow this consultation closely and to consider making similar changes to the IFRS for SMEs.

b) Fall-back to IFRS 9

41. Paragraphs 11.2 and 12.2 of the IFRS for SMEs give entities the option of applying both sections 11 and 12 in full or of applying the recognition and measurement provisions of IAS 39 and the disclosure requirements of sections 11 and 12. We are surprised that the board has not taken this opportunity to add an additional option allowing entities to apply the recognition and measurement provisions of IFRS 9 now that the replacement for IAS 39 is nearing completion. At the very least, we encourage the board to allow this option once IFRS 9 has been finalised and is available for early adoption by users of full IFRS.

42. Moreover, we are concerned that the fall-back does not work in its current form as IAS 39 is now only a partial standard as various sections have been withdrawn and replaced by the equivalent requirements of IFRS 9. Clarification is needed as to which version of IAS 39 the fall-back applies to ie, the version that pre-dates the consequential amendments arising out of IFRS 9.

c) Amendments to IAS 19

43. We are disappointed that the board has decided not to reflect at least some of the 2011 amendments to IAS 19 in the IFRS for SMEs. Including a narrow amendment reflecting the new requirements for a net interest amount, calculated using the liability discount rate, to be recognised in the income statement instead of an expected return on plan assets and an interest cost would not only enhance consistency with full IFRS but would also be a significant simplification for users of the IFRS for SMEs, as they would no longer have to establish appropriate expected return figures. We therefore urge the board to reconsider their decision.

Question 5 – Transition provisions

The IASB does not expect retrospective application of any of the proposed amendments to be significantly burdensome for SMEs and has therefore proposed that the amendments to the IFRS for SMEs in Sections 2–34 are applied retrospectively.

Do you agree with the proposed transition provisions for the amendments to the IFRS for SMEs? Why or why not? If not, what alternative do you propose?

44. We agree with the proposed transition provisions.

Question 6 – Effective date

The IASB does not think that any of the proposed amendments to the IFRS for SMEs will result in significant changes in practice for SMEs or have a significant impact on their

financial statements. It has therefore proposed that the effective date of the amendments to the IFRS for SMEs should be one year after the final amendments are issued. The IASB also proposes that early adoption of the amendments should be permitted.

Do you agree with the proposed effective date and the proposal to permit early adoption? Why or why not? If not, what alternative do you propose?

45. We agree with the proposed effective date and support the proposal to permit early adoption.

Question 7 – Future reviews of the IFRS for SMEs

When the IFRS for SMEs was issued in 2009 the IASB stated that after the initial comprehensive review, the IASB expects to propose amendments to the IFRS for SMEs by publishing an omnibus Exposure Draft approximately once every three years. The IASB further stated that it intended this three-year cycle to be a tentative plan, not a firm commitment. It also noted that, on occasion, it may identify a matter for which an amendment to the IFRS for SMEs may need to be considered earlier than in the normal three-year cycle; for example to address an urgent issue.

During the comprehensive review, the IASB has received feedback that amendments to the IFRS for SMEs once every three years (three-year cycle) may be too frequent and that a five-year cycle, with the ability for an urgent issue to be addressed earlier, may be more appropriate.

Do you agree with the current tentative three-year cycle for maintaining the IFRS for SMEs, with the possibility for urgent issues to be addressed more frequently? Why or why not? If not, how should this process be modified?

46. While we acknowledge that many small and medium-sized entities appreciate stability, we feel that this is adequately provided by the existing three year review cycle and that this should be retained rather than extended to five years. A longer review cycle would increase the risk of unwarranted inconsistencies between IFRSs and the IFRS for SMEs.

47. We accept that the process of reviewing the IFRS for SMEs takes time. The board needs to ask for ideas, examine the issues raised, prepare a board paper, issue a discussion paper and/or exposure draft, collate the responses and, finally, issue a new version of the standard. There is then further time until the new version becomes compulsory, so the three years can easily become four or even five.

48. Nonetheless, we feel that the three year review cycle should result in an updated standard being effective three years after the previous iteration. This will clearly not be the case for the first review as the revised standard is not expected to be effective until 2016 – over seven years after it was issued and some five or six years after many entities began applying it. While we accept that this first review is something of an exception, we nonetheless, reiterate that future reviews should be undertaken on a timelier basis.

Question 8 – Any other comments

Do you have any other comments on the proposals?

49. We have no additional comments.

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