Accounting Standards Board
Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2301
www.frc.org.uk/asb

Stig Enevoldsen
Chairman
European Financial Reporting Advisory Group
Avenue des Arts 13-14
1210 Brussels
Belgium

6 July 2007

E-mail: Commentletter@efrag.org

Dear Stig

IASB's ED IFRS for SMEs

This letter sets out the ASB's comments on the draft EFRAG comment letter on the above IASB Exposure Draft.

The ASB is currently seeking comments from UK and Irish constituents on the proposed IFRS for SMEs. Consequently, the views expressed by the ASB in this response represent the tentative views of the Board and could differ from our formal response to the IASB after taking into consideration this feedback.

That said, the ASB has concerns with the message being given in the EFRAG draft comment letter, which is that the IFRS for SMEs should be fundamentally reworked. This view is reinforced by the feedback we have received from roundtable events in the UK and Ireland which is that the IASB Exposure Draft is generally a good document that should provide a sound basis for financial reporting. The ASB does not think the IASB will, at this stage, completely re-write the document and re-expose it for comment; hence it may be more helpful for EFRAG to summarise the most important changes it thinks are necessary.

This letter provides comments on the six suggested topics that EFRAG considers could further improve the standard, as outlined in your draft covering letter (see Appendix A), and the ASB's initial feedback to EFRAG's answers to the IASB's invitation to comment (see Appendix B).

The ASB acknowledges the considerable work that has been undertaken in producing attachment 2 (detailed comments on existing sections) and attachment 3 (proposal and illustration of an alternative IFRS for SMEs) in your draft comment letter. Given that we are still consulting our constituents on the IASB's ED, the ASB is not commenting on the details of those attachments.

Yours sincerely

Ian Mackintosh
Chairman
DDI: 020 7492 2434
Email: i.mackintosh@frc-asb.org.uk

Appendix A

1 The final standard should be a comprehensive stand alone document

EFRAG believes that the objective of a self contained, comprehensive set of standards can be achieved. The IASB has already taken key steps towards achieving that goal, i.e. they have included some measurement pervasive principles in the standard and have also eliminated the general fall back to full IFRS from the requirement hierarchy. To fulfil the objective entirely, all remaining cross-references, both optional and mandatory should be eliminated. EFRAG provides in its more detailed comments recommendations on how to eliminate those cross-references. This, in EFRAG's view, can be accomplished while making the standard even more concise than is currently reflected in the ED. EFRAG has also provided re-drafting and restructuring guidelines that can eliminate the need for cross references.

The ASB supports the objective of a stand alone document for the IFRS for SMEs and agrees with EFRAG that the IASB has already taken key steps towards achieving that goal.

The ASB disagrees with EFRAG's recommendation for eliminating mandatory fallbacks. The ASB is content for sections 31, 34 and 37 to be retained if an entity chooses to disclose earnings per share, segment and interim reporting, especially as these disclosures are rarely produced by SMEs.

The ASB also agrees with the IASB with the fact that the proposed IFRS for SMEs does not include requirements for hyperinflationary economies because it is uncommon for SMEs to have a hyperinflationary functional currency.

2 "IFRS for SMEs" is not the most appropriate label

EFRAG has observed that the present label "IFRS for SMEs" quite often creates misunderstandings. The label "SME" is widely used internationally to refer to the size of entities in general. The scope of the ED, which excludes all entities which meet the proposed definition for public accountability, does not refer to size criterion of any kind, and EFRAG believes, rightfully so. Therefore EFRAG recommends that a different label be selected when naming the final standard. EFRAG recommends that the IASB revert to one of its earlier tentative decisions and re-label this set of standards as "IFRS for NPAE's" (non publicly accountable entities), unless it is able to identify a better label.

The ASB agrees with EFRAG's recommendation that the present label 'IFRS for SMEs' is misunderstood and should be relabelled. That said, the ASB does not like the term 'non-publicly accountable entities'. The ASB's view is that a more appropriate title should be considered by the IASB, but we do not have a ready suggestion for a more appropriate title.

3 Users' needs ought to be analysed further and more changes to recognition and measurement principles may be needed.

In its basis for conclusions, the IASB acknowledges that users' needs of NPAEs are different from those of users of financial statements of publicly accountable entities. The IASB also clearly indicates that these differences need to be reflected in different recognition and measurement principles. EFRAG agrees with those conclusions. However EFRAG believes that these conclusions have not been fully taken into account in the decisions made by the IASB. Therefore EFRAG recommends that a further analysis be conducted and more changes to the existing measurement requirements may be necessary in order to better serve the needs of users'. For example, EFRAG believes that the use of market prices should only be used for the revaluation of assets and liabilities when an active market exists and a disposal or transfer is a possible scenario for the entity.

> The ASB agrees with EFRAG's comments that the IASB has acknowledged that the user needs of NPAEs are different from those users of financial statements of publicly accountable entities. However, the ASB disagrees with EFRAG's recommendation that a further analysis of user requirements needs to be conducted, as well as the need for more changes to the existing measurement requirements. Should such an analysis be conducted, the analysis, conclusions and recommendations to change any aspect of the proposed IFRS for SMEs will be time consuming, will probably require re-exposure and will further delay the publication of the long awaited standard.

4 More simplifications in recognition and measurement should be considered

The IASB has put forward in its ED some simplifications in the recognition and measurement requirements in general, which denotes a valuable and vital step forward in this project. However EFRAG believes that further simplifications can be made, while remaining consistent with the IFRS conceptual framework. These simplifications include, inter alia, reinstating the amortisation of goodwill and other intangible assets, promulgating only one cost model and one revaluation model for non-financial assets, eliminating the reference to the name "fair value", and eliminating the recognition of equity settled share-based payments. Also, simplifications already made by the IASB need to be improved. For example, fair value as the default measurement attribute for financial assets and liabilities is inappropriate, in EFRAG's view, and results in requirements which are still quite difficult to understand and to implement.

> While the ASB acknowledges the considerable commentary provided by EFRAG on this topic, at this stage it is not in a position to comment on whether more simplifications in recognition and measurement should be considered. The ASB will look at this once it has had the opportunity to consider the feedback from its consultation paper on the proposed IFRS for SMEs.

5 Differences with full IFRS may be warranted when a need for improvement has been identified and is particularly relevant for SMEs (equity/liability split)

EFRAG is aware that in some jurisdictions partnerships, cooperatives or other forms of corporation have puttable equity instruments. Often these entities are not publicly accountable and are therefore within the scope of this standard. EFRAG believes that some changes are warranted with respect to the debt/equity classification (such as but not limited to what the IASB is considering for full IFRS) in order to address the anomalous outcome of an entity having negative or no equity at all although it is still very much a going concern.

The ASB agrees with EFRAG's concerns on this topic, but we do wonder what further changes EFRAG is asking for from the IASB. We note that in commenting on the equity section of the ED (Attachment 2, page 13), EFRAG argues "that an exception be made to the definition of liabilities" but without specifying what that exception might be.

6 The standard could benefit from being redrafted

Although the IASB has made the right decision in terms of organising the standard by topic, we believe that the final IFRS for SMEs ought to be more user-friendly than is currently the case. EFRAG believes that the standard can benefit from restructuring and re-drafting in the following ways:

- The standard could be reorganised in sections and subsections, so that for example, all requirements for non-financial assets or group accounting would be grouped together;

- Principles and application guidance could be separated from each other, so that principles could be emphasised and better understood, while more guidance would be provided;

- Where principles and guidance are the same, no repetition from section to section is needed; this approach could aid understandability and conciseness.

The ASB does not consider that widespread changes are appropriate or necessary. The ASB agrees with the approach adopted by the IASB in terms of organising the standard by topic.

Appendix B

Attachment 1: Answers to the invitation to comment

Question 1 – Stand alone document

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?

Please refer to the ASB's comments on item1 in Appendix A of this letter.

Question 2 – Recognition and measurement simplifications that the Board adopted

Are there other recognition and 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;

(c) how that problem might be solved.

In general, the ASB's initial view is that the recognition and measurement simplifications proposed by the IASB are satisfactory. That said, we do support the principle of further simplifications, where appropriate. One issue on which the ASB supports EFRAG's view that value in use should be reinstated as a possible basis for impairment tests (Attachment 1, page 6 (3) (a)).

Please refer to comments on item 4 in Appendix A of this letter.

Specific EFRAG Constituent questions:

<u>(c) Scope in for commodities is too complex for an SME</u>

Sec. 11.4 for non-financial items and the scope exclusions of Sec. 11.3(c) and (e) for leases and insurance contracts lead to a scope extensions for commodities that are similar to instruments dealt with in IAS 39.11. Compared to IAS 39.11 Sec. 11 only covers non-financial contracts with (i) underlyings other than prices and foreign exchange rates and (ii) only when losses could arise to the buyer or seller as a result of the contractual terms. EFRAG questions whether that means that non-financial contracts with interest rate risks are in the scope of section 11 and should be measured at FV in their entirety.

Furthermore it is EFRAG's understanding that Sec. 11 results in every contract including an embedded derivative not economically related to the contract to be accounted for at fair value.

View 1

EFRAG disagrees with that requirement and would rather support that the IFRS for SMEs does not ask for a separation from the host contract of these instruments (ie no *embedded* derivatives). EFRAG suggests that IASB should omit the above mentioned paragraphs in Sec. 11 as it too complex for an SME to identify this kind of instruments and to determine their fair value.

View 2

EFRAG disagrees with that requirement and would rather support that the derivative be separated out, whether the host contract is a financial instrument or a non-financial item. In EFRAG's view, it is useful for SMEs to have to identify risks they accept beyond the risks inherent to the contracts to which they commit and to keep track of the basic financial con-sequences of the other contractual terms they accept in the normal course of their business.

EFRAG believes that derivatives ought to be defined in the IFRS for SMEs. Criteria set out in 11.3 and 11.4 could be used to identify the derivatives which need to be accounted for separately from host contracts.

Question to EFRAG constituents:

Do you prefer view 1 (embedded derivatives are not recognized) or view 2 (they are recognized via split accounting)? Do you wish to gather some input and raise a question to our constituents?

ASB response:

With the objective of simplicity the ASB supports view 1.

(h) Derecognition scheme has been shortened at the cost of covering certain transactions

EFRAG welcomes the attempt to simplify the derecognition criteria for financial assets. However as acknowledged in the basis for conclusions (BC73), simplifications may remove guidance on how to account for "complex" transactions. In EFRAG's view, removing the continuing involvement criterion may prevent SMEs from accounting for securitizations and factoring transactions appropriately. Indeed, if an SME retains control of a transferred asset the entity has to continue to recognise the transferred asset in its entirety. This could lead to the result that certain securitizations and factoring transactions would not result in a derecognition of the corresponding financial assets under Sec. 11. EFRAG however believes that securitization and factoring transactions are not uncommon for SMEs.

Questions to EFRAG constituents:

1. Are securitization and factoring transactions common transactions for SMEs? Is the simplification made by the IASB appropriate? 2. If not, what accounting guidance should be provided?

ASB response:

The ASB agrees with EFRAG that securitization and factoring transactions are common for SMEs. The ASB refers EFRAG to the guidance provided in sections 8.10 – 8.12 'Debt Factoring' of the Financial Reporting Standard for Smaller Entities (FRSSE) and consider this guidance maybe a more appropriate accounting approach.

(i) Hedge accounting became simpler but also more restrictive

The simplified hedging approach proposed in Sec 11 is welcomed as a genuine attempt to simplify a very complex set of provisions. EFRAG agrees that restricting hedging accounting to the circumstances in which the "almost fully offset" test is met would have been too restrictive. However EFRAG believes that the shortcut method should remain available to be applied in all circumstances in which the cost and burden of testing the effectiveness of hedges could be spared. As a consequence, EFRAG would support both methods being available in the standard.

When using an effectiveness test as criteria for hedge accounting clarification is needed on how to measure this effectiveness.

Questions to EFRAG constituents:

The simplified hedging approach goes along with some restrictions which might cause problems in practice:

1. Sec. 11.31 only allows hedging for four specific risks. Is that too restrictive?
2. Sec. 11.32 only allows hedging for certain hedging instruments. Is that too restrictive?

ASB response:

The ASB also welcomes the genuine attempt to simplify a very complex set of provisions. We consider that the draft standard permits appropriate hedge accounting for a typical SME.

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

Should the Board reconsider any of those and, if so, why?

The ASB agrees with the EFRAG response.

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

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?

The ASB agrees with EFRAG that most options in full IRFS should be available in the IFRS for SMEs. We are not aware of any options that would be available to SMEs by cross-reference to the full IFRSs that should be eliminated from the draft IFRS for SMEs.

Question 5 – Borrowing costs

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

The ASB agrees with the EFRAG response.

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

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

Please refer to the ASB's comments on item 1 of this letter.

Question 7 – General referral to full IFRSs

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?

The ASB agrees with the hierarchy as set out in paragraphs 10.2 – 10.4. They address the criteria management shall use in developing and applying an accounting policy if the IFRS for SMEs does not specifically address a transaction, other event or condition. However, the ASB agrees with the IASB on explicit cross-references to particular IFRSs.

Question 8 – Adequacy of guidance

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

The ASB disagrees with EFRAG's response. We agree with the approach adopted by the IASB and do not consider it appropriate to redrafting the guidance as recommended by EFRAG.

Question 9 – Adequacy of disclosures

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?

The ASB notes that EFRAG has not yet dealt with this issue.

Question 10 – Transition guidance

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

The ASB agrees with the EFRAG response.

Question 11 – Maintenance of the IFRS for SMEs

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

The ASB agrees with the approach adopted by the IASB. Periodic updates will enable entities to have the opportunity to evaluate the impact of any required changes in advance of their implementation.