



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

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Your ref:

Stig Enevoldsen
Chairman
Technical Expert Group
EFRAG
Avenue des Arts 13-14
B-1000 BRUXELLES

commentletter@efrag.org

Dear Stig

IFRS for SMEs

The ICAEW has already submitted to EFRAG a copy of our own submission to the IASB. Following some further analysis of the draft EFRAG response to the IASB I now attach some further comments for your attention. I hope that these are helpful.

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

Yours sincerely

Dr Nigel Sleight-Johnson
Head of Financial Reporting
T +44 (0)20 7920 8793
F +44 (0)20 7638 6009
E nigel.sleight-johnson@icaew.com

Chartered Accountants' Hall
PO Box 433 Moorgate Place London EC2P 2BJ
www.icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City



ICAEW Representation

ICAEW REP 110/07

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

Memorandum of comment submitted in October 2007 by The Institute of Chartered Accountants in England and Wales to EFRAG on the IASB consultation paper *Proposed International Financial reporting Standard for Small and Medium-sized Entities*

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the draft EFRAG letter to the IASB on the consultation paper *Proposed International Financial reporting Standard for Small and Medium-sized Entities* published by the International Accounting Standards Board ('the Board').

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 129,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

GENERAL COMMENTS

4. We congratulate EFRAG on producing a comprehensive and high quality set of comments for consideration by the Board. We have not sought to comment in detail on the extensive EFRAG commentary, but have highlighted below significant issues where we strongly support the EFRAG letter – and would not wish to see it diluted – and others where in our own response we have taken a significantly different line from EFRAG or have made important additional points to the Board.
5. We are content with a substantial number of EFRAG's specific comments. In particular, we strongly support EFRAG's recommendation that:
 - the Board creates a comprehensive, fully stand-alone product, without any cross-references to full IFRS;
 - the label 'IFRS for SMEs' is replaced with 'IFRS for NPAEs' or something similar;
 - paragraph 1.3 of the draft IFRS is eliminated;
 - there should be an option to expense or to capitalise interest;
 - the amortisation of goodwill and other intangibles is reinstated - but on an optional basis; and
 - the recognition of equity-settled share-based payments is eliminated.
6. The ICAEW is, however, perhaps more welcoming overall of the Board's draft standard. We applaud the efforts of the Board to produce a high-quality, slimmed-down alternative to full IFRS in response to the demand from constituents, and, although we too have made detailed recommendations for further improvement, find much to commend. The project provides an unprecedented opportunity to establish a widely-used accounting framework for private companies that wish to prepare general purpose financial statements bearing a close family resemblance to IFRS, which will encourage best accounting practice.

7. Our experience to date is that the complexity of full IFRS taxes the resources and capabilities of even listed companies. We therefore anticipate that many large private companies that perceive an advantage in reporting in accordance with internationally-recognised standards will be interested in utilising this new IFRS product. We agree with EFRAG that the draft standard is too complex to be suitable for application by most small companies. Indeed, the prospect of the Board producing a single standard that met the very different user needs of the complete spectrum of unlisted businesses was always remote. Nevertheless, we are optimistic that the IFRS for SMEs could be used as a valuable point of reference for the development of simpler standards for use by small entities.
8. We have therefore taken a somewhat different approach from EFRAG in calling for changes to the draft standard. We do not think that the appeal of the current draft standard can be widened significantly. On the one hand, for the IFRS for SMEs to be suitable for larger companies, a certain degree of complexity will be unavoidable. On the other, radical simplification would be necessary before the proposed IFRS for SMEs was suitable for very small companies. We are not convinced that this circle can be squared. We have offered instead to assist the Board in determining the minimum additional simplifications necessary to develop a third tier product attractive to small and, in particular, micro entities. This would be a much shorter and simpler document, incorporating only the simplest of the optional treatments included in the IFRS for SMEs. In most cases this would preclude inclusion of accounting treatments involving the use of fair value measurement.

COMMENTS ON SPECIFIC TOPICS

The Structure of the Draft Standard

9. We applaud EFRAG's efforts to suggest an improved structure for the standard. In our response we concluded that this could be achieved by presenting the contents of each section in such a way that it is very clear to those preparing accounts for a business with less complex transactions that the preparer need read no further, through for example changing the order of certain sections, putting the most commonly used principles and rules first, and boxing and shading. This less ambitious approach recognises the risk that a substantial redraft of the future IFRS for SMEs may lead to a lengthy delay in its finalisation.

Selection of Accounting Policies

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

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

Financial Instruments

12. We agree with EFRAG that the proposed accounting requirements for financial instruments are still too complex and the guidance provided not sufficiently clear. We also strongly agree that fair value should not be the default basis of measurement. In our view, loans, receivables and financial instruments such as those described in paragraph 11.10 of the draft standard should be measured at cost or amortised cost less impairment, supplemented by the disclosures on risk set out in paragraph 11.52. Other financial instruments, such as those described in paragraph 11.11, should be measured at fair value if this can be readily determined without undue cost or effort. Otherwise, they should be measured at cost or amortised cost less impairment. This treatment would eliminate the need to designate instruments, including most of the everyday ones, that are to be measured at amortised cost, and hence the detailed and rather impenetrable material at paragraphs 11.9 and 11.10 could be excluded.

Embedded Derivatives

13. We agree with the EFRAG ('view 1') that the IFRS for SMEs should not call for embedded derivatives to be accounted for. However, we consider that the draft standard should make a brief, specific reference to derivatives, to avoid any uncertainty over their accounting treatment. Paragraph 11.2(h); for example, could read 'Derivatives such as options ... etc'. In addition, a brief reference to embedded derivatives - and more particularly the lack of any requirement to separate them from the host instrument - should be added to the Basis for Conclusions to avoid uncertainty for users of the standard who are also familiar with full IFRS.

Business Combinations

14. We are not convinced that it would be appropriate to simplify the method for allocating the cost of a business combination by eliminating the requirement to allocate contingent liabilities (Attachment 2, Section M, of the draft EFRAG letter). In our view this section of the standard would however be enhanced significantly by the inclusion of clear guidance on the acquisition of entities or groups of assets that are not businesses (such as the material in paragraph 4 of IFRS 3); on common control; and on reverse acquisitions and step acquisitions.

Employee Benefits

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

Deferred Tax

16. We agree with EFRAG's support for the Board's attempt to simplify accounting for deferred taxes by basing it on timing differences. However, we find the analysis and explanations in Section 28 in need of much further simplification and

restructuring, with clear principles and explanations provided at the outset. Once redrafted, we strongly suggest that the clarity of this section is tested with a number of potential users of the standard with no background in IFRS.

Segment Reporting

17. Whilst we agree that NPAEs should not be required to present information about operating segments, we do not agree with EFRAG that the section on segment reporting should simply be deleted. The second and third sentences of paragraph 31.1 are needlessly restrictive and damaging to good financial reporting. Paragraph 3.1 requires additional information if it is necessary for a fair presentation and we do not believe that the Board should be discouraging additional segmental disclosure. We suggest that the second and third sentences of paragraph 31.1 should be deleted, and replaced with a comment that segmental information may be presented but must be accompanied by adequate disclosure regarding the basis of preparation.

Disclosures

18. In general, we consider the level of disclosure requirements in the draft standard to be appropriate. We have pointed out to the Board a number of disclosure requirements in sections 18 and 19 that we regard as unnecessarily onerous. However, we doubt that the list of minimum disclosures set out in the draft EFRAG letter would meet the needs of the users of the financial statements of the larger NPAEs that might use the standard.

Email: nigel.sleigh-johnson@icaew.com

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