Financial Reporting Council

IASB
30 Cannon Street
London
EC4M 6XH

Submitted electronically via www.iasb.co.uk

30 November 2012

Dear Sirs

The Comprehensive Review of the IFRS for SMEs

I am writing on behalf of the UK's Financial Reporting Council (FRC) in response to the IASB's *Request for Information – Comprehensive Review of the IFRS for SMEs*.

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

As you know, in the UK we are proposing to introduce a new accounting standard for entities not applying EU-adopted IFRS, that is based on the IFRS for SMEs. We have used our experience in developing that accounting standard to be suitable for use in the UK and Republic of Ireland from the IFRS for SMEs, including feedback from external consultations, to inform our response to your request for information.

We set out below our comments on some of the key themes associated with the review. In particular we consider the issues of scope (in relation to public accountability) and the integration of new and revised IFRSs to be significant matters that the IASB should consider in order to appropriately focus its efforts in conducting the review.

The objective of the Comprehensive Review

As it currently stands, we feel that the scope of this review is not well defined and that the IASB would benefit from clarifying its objective for the review. Clarification of the objective would enable a more structured review, with a clear basis for decisions about whether or not to amend the IFRS for SMEs. Further, we feel that the questions that have been posed are too narrow and do not invite respondents to consider the wider consequences of their responses. In particular, we have found that when considering issues relating to the scope of the standard, it is likely that a corollary to a change in scope will be changes to the accounting and reporting requirements of the standard.

We have not addressed each specific question in the review in turn; instead we feel that the questions can be grouped into three key areas of discussion (plus other issues) and that these need to be addressed before the detail of each question can be considered.

The three key areas of discussion (plus other issues) identified are as follows, with the questions relating to them:

1. The scope of the IFRS for SMEs:

- S1: Use by publicly traded entities (Section 1);
- S2: Use by financial institutions (Section 1);
- S3: Clarification of use by non-for-profit entities (Section 1).

2. The integration of new or revised IFRSs:

- S4: Consideration for recent changes to the consolidation guidance in full IFRSs (Section 9);
- S5: Use of recognition and measurement provisions in full IFRS for financial instruments (Section 11);
- S6: Guidance on fair value measurement for financial and non-financial items (Section 11 and other sections);
- S7: Positioning of fair value guidance in IFRS for SMEs (Section 11);
- S8: Consideration of recent changes to accounting for joint ventures in full IFRS (Section ?);
- S12: Consideration of changes to accounting for business combinations in full IFRSs (Section 15);
- S15: Presentation of actuarial gains or losses (Section 28);
- G1: Consideration of minor improvements to full IFRSs.

3. Areas of current divergence between full IFRS and IFRS for SMEs:

- S9: Revaluation of property, plant and equipment (Section 17);
- S10: Capitalisation of developments costs (Section 18)
- S11: Amortisation period for goodwill and other intangible assets (Section 18);
- S14: Capitalisation of borrowing costs on qualifying assets (Section 25);
- S16: Approach for accounting for deferred income taxes (Section 29);
- S17: Consideration of IAS 12 exemptions from recognising deferred taxes and other differences under IAS 12 (Section 29);
- S18: Rebuttable presumption that investment property at fair value is recovered through sale (Section 29).

4. Other issues:

- S13: Presentation of share subscriptions receivable (Section 22);
- S19: Inclusion of additional topics in the *IFRS for SMEs*;
- S20: Opportunity to add your own specific issues;
- G2: Further need for Q&As;
- G3: Treatment of existing Q&As;
- G4: Training material;
- G5: Opportunity to add any further general issues;

- G6: Use of IFRS for SMEs in your jurisdiction.

Principles for amending the IFRS for SMEs

We suggested to the IASB, in our response on its Agenda Consultation 2011, that it should take items onto its agenda where there is reasonable evidence that a project will fix a gap in existing accounting literature, or result in significant improvement in the transparency of financial reporting. Similarly we think the IASB should develop, consult on, and adopt a set of principles to apply in determining whether or not to amend the IFRS for SMEs. These might include consideration of whether:

- the financial statements of entities within the scope of the IFRS for SMEs would be improved by the change (for example, by more transparent information being available to users, such as lenders);
- the issue that gave rise to the agenda item in the context of full IFRS applies equally to entities within the scope of the IFRS for SMEs;
- given the single conceptual framework, can a divergence in treatment between the recognition and measurement requirements of full IFRS and the IFRS for SMEs be justified in accordance with that framework.

All improvements to IFRS should be considered against the principles, to determine whether an amendment to the IFRS for SMEs should be proposed. Where amendments to full IFRS are reflected in the IFRS for SMEs, this may be in a simplified form.

The scope of the IFRS for SMEs

We believe it would be beneficial for the IASB to revisit the scope of the IFRS for SMEs in more general terms before any detailed questions of scope are addressed. One of the key issues any jurisdiction faces when considering implementing the IFRS for SMEs is what type(s) and size(s) of entity should apply, or be prohibited from applying, the standard.

We have considered these issues in determining the scope of the UK accounting standard based on the IFRS for SMEs. In relation to public accountability, respondents told us that particularly for smaller entities that hold assets for the benefit of others, the cost of applying full IFRS outweighed the benefits. After considering the comments, and the differences between full IFRS and the IFRS for SMEs, we concluded that there are few recognition and measurement differences, and that we could introduce some additional disclosure requirements for these entities that would provide an appropriate balance of understandable information to users, as a reasonable cost. We recommend that the IASB reconsiders the scope of the IFRS for SMEs, as set out in questions S1, S2 and S3.

Although we appreciate the debate regarding the relative costs and benefits to small and medium sized entities (SMEs) of applying more complex accounting treatments, many respondents to the FRC's recent consultation on the Future of Financial Reporting in the UK and Republic of Ireland (RoI) felt that the IFRS for SMEs was oversimplified in some areas and was therefore not suitable for use in the UK and RoI without amendment. As a result, we developed guidelines for use when considering amendments to the IFRs for SMEs in drafting a standard for use in the UK and RoI; these maintain an IFRS-based standard but permit amendments meeting certain criteria. We are currently in the process of finalising the UK standard based on the IFRS for SMEs.

In general, we are of the opinion that it is beneficial for all entities to report using a consistent framework and therefore the IASB should create a suite of standards using the same underlying principles, but that each jurisdiction should then decide which standards should apply to which type(s) and size(s) of entity and how relevant legislation impacts the standard. We note that, prior to the adoption of the IFRS for SMEs (or a standard based on the IFRS for SMEs) there may be different levels of accounting and reporting sophistication in different jurisdictions; the introduction of accounting policy options in certain areas of the IFRS for SMEs might help ensure the IFRS for SMEs has the widest possible applicability.

We found that where the scope of our standard diverges from the IFRS for SMEs it has required careful consideration of whether or not additional requirements should be included to adequately address the needs of the users of those entities' financial statements.

Integration of new and revised IFRSs within the IFRS for SMEs

We have partially addressed this above; we believe that the principles of any new or updated IFRS should be considered for incorporation into the IFRS for SMEs and an explanation should be provided of how its incorporation, or otherwise, fits with the principles for amending the IFRS for SMEs.

Areas of current divergence between full IFRS and the IFRS for SMEs

We have found that, when implementing an IFRS-based framework for entities other than those that are required to apply full IFRS, it is important to a number of entities that they are not prohibited from applying accounting options that are available (or required) by full IFRS. This may be, for example, because they feel the option not permitted by the IFRS for SMEs gives a more faithful representation of the financial position, or performance, of their business, or because they may be compared with entities reporting under full IFRS and wish to be able to choose consistent accounting policies. In short a number of our respondents felt that these areas of divergence were an over-simplification for the UK and RoI, and there was insufficient evidence to justify a change from current practice.

As a result we have included a number of accounting policy options in our UK accounting standard based on the IFRS for SMEs (eg revaluation of property, plant and equipment and intangible assets, capitalisation of development costs and borrowing costs), and would encourage the IASB to include these options in the IFRS for SMEs. We understand that options such as revaluation may have been excluded on the basis that it is the more complex alternative. However, if the IASB wanted to signal which is the simpler of two alternatives, it could include a 'default' or straightforward alternative (eg cost) and a permitted alternative (eg revaluation). This puts the cost-benefit decision in the hands of the preparers. Different jurisdictions might also take different views about whether or not to permit the alternatives.

We developed a set of guidelines to assist in evaluating potential amendments to the IFRS for SMEs to ensure that the resulting standard was IFRS-based, and made amendments by reference to full IFRS wherever possible. Appendix A notes those areas where we introduced accounting options for application in the UK and RoI.

In addition to these areas, one significant area of divergence between full IFRS and the IFRS for SMEs relates to deferred tax. As the IFRS for SMEs requirements are based on an Exposure Draft not pursued by the IASB, the FRC considered an alternative approach. Our respondents rejected incorporating IAS 12 *Income taxes*, and we have developed an alternative, the 'timing differences plus' approach which is derived from current UK accounting requirements and adapted to achieve, in practice, accounting for deferred tax that is usually consistent with the outcome under IAS 12. We recommend that the IASB reviews the IFRS for SMEs' requirements for deferred tax, but note that in our experience IAS 12 is considered unsuitable for those applying the IFRS for SMEs.

Other issues

In developing the UK accounting standard from the IFRS for SMEs, a number of amendments have been made. In Appendix B we set out a high level summary of the amendments we have made, which the IASB might consider as possible areas to review in the IFRS for SMEs.

If you have any queries, or would like to discuss our comments in more detail, please do not hesitate to contact Jenny Carter (Project Director, 020 7492 2421, j.carter@frc.org.uk) or Michelle Sansom (Director of Accounting, 020 7492 2432, m.sansom@frc.org.uk).

Yours faithfully

Roger Marshall

FRC Board member and Chair of the Accounting Council

DDI: 020 7492 2440

Email: r.marshall@frc.org.uk

Appendix A

Amendments to IFRS for SMEs for use in the UK and Republic of Ireland

During the consultation process on the proposed new Financial Reporting Standards in the UK and Republic of Ireland (RoI), the FRC considered the issue of whether the IFRS for SMEs should be amended to make it more suitable for use in the UK and RoI.

Current areas of divergence between full IFRS and the IFRS for SMEs

Below is a summary of the accounting treatments under full IFRS and the IFRs for SMEs along with the amended accounting treatment per the proposed UK standard for questions S9 – S11 and S14 of the Comprehensive Review document.

S9: Revaluation of property, plant and equipment (Section 17)

Full IFRS	**IFRS for SMEs**	**Draft UK standard**
IAS 16 Property, plant and equipment	*Section 17*	*Section 17*
Choice – hold at cost or revalue	No choice – hold at cost	Choice – hold at cost or revalue

The Basis for Conclusions to the IFRS for SMEs did not give a justification for the removal of the choice to revalue property, plant and equipment but it is assumed that it was to allow only the simpler option for cost-benefit reasons.

We concluded that we would include the option to revalue in the proposed UK standard on the basis that the choice exists under current UK standards and it aligns with full IFRS. The cost of change and potential implications for borrowing arrangements of those entities already choosing to revalue could not be justified.

S10: Capitalisation of development costs (Section 18)

Full IFRS	**IFRS for SMEs**	**Draft UK standard**
IAS 38 Intangible assets	*Section 18*	*Section 18*
No choice – if development costs meet certain criteria, they shall be capitalised.	No choice – expense development costs.	Choice – if development costs meet certain criteria they may be capitalised or expensed.

The IASB stated in its Basis of Conclusions for the IFRS for SMEs that "many preparers of SMEs financial statements said that SMEs do not have the resources to assess whether a project is commercially viable on an on-going basis and furthermore capitalisation of only a proportion of the development costs does not provide useful information. Bank lending officers told the Board that information about capitalised development costs is of little benefit to them, and that they disregard those costs in making lending decisions." (IFRS for SMEs, paragraph BC113)

The FRC concluded that it would include the choice to either capitalise or expense development costs in the proposed UK standard on the basis that the choice exists under current UK accounting standards and capitalisation aligns with full IFRS. Further, for those entities engaged in significant development activities, it is likely that they are able to assess the viability of projects. Permitting a choice allows those entities that do not wish to incur the on-going costs of assessing the viability of a project to choose to expense development costs.

S11: Amortisation period for goodwill and other intangible assets (Section 18)

Full IFRS	**IFRS for SMEs**	**Draft UK standard**
IAS 38 Intangible assets	*Section 18*	*Section 18*
Goodwill – not amortised. Other intangibles - not explicitly stated.	If an entity is unable to make a reliable estimate of the useful life of an intangible asset, including goodwill, it is presumed to be ten years.	If an entity is unable to make a reliable estimate of the useful life of goodwill or an intangible asset it shall not exceed five years.

The IASB stated in its Basis of Conclusions for the IFRS for SMEs that for “cost-benefit reasons, rather than conceptual reasons – that goodwill and other indefinite-lived intangible assets should be considered to have finite lives” (IFRS for SMEs, paragraph BC112).

The subsequent measurement of goodwill and intangible assets is addressed in EU and UK company law, which restricted the accounting options available to the FRC. The useful life was changed from ten to five years to comply with EU law.

S14: Capitalisation of borrowing costs on qualifying assets (Section 25)

Full IFRS	**IFRS for SMEs**	**Draft UK standard**
IAS 23 Borrowing costs	*Section 25*	*Section 25*
No choice – capitalise only	No choice – expense only.	Choice – capitalise or expense borrowing costs.

The IASB stated in its Basis of Conclusions for the IFRS for SMEs that for “cost-benefit reasons, the IFRS for SMEs requires such costs to be charged to expenses.” (IFRS for SMEs, paragraph BC120).

The FRC decided to permit either method in the proposed UK standard.

Appendix B

Amendments to IFRS for SMEs for use in the UK and Republic of Ireland

When developing the proposed new UK accounting standard based on the IFRS for SMEs a number of amendments were made. Some of those amendments were necessary for compliance with UK and EU law, but otherwise the following guidelines were applied in determining which changes should be made.

When considering amendments to the IFRS for SMEs:

a) changes should be made to permit accounting treatments that exist in FRSs at the transition date that align with EU-adopted IFRS;

b) changes should be consistent with EU-adopted IFRS unless a non-IFRS-based solution clearly better meets the objective of providing high-quality understandable financial reporting proportionate to the size and complexity of the entity and the users' information needs. In these cases elements of an IFRS-based solution may nevertheless be retained;

c) use should be made, where possible, of existing exemptions in company law to avoid gold-plating; and

d) changes should be made to provide clarification, by reference to EU-adopted IFRS, that will avoid unnecessary diversity in practice.

Part A: Specific questions

S19: Inclusion of additional topics in the *IFRS for SMEs*;

S20: Opportunity to add you own specific issues;

The table below gives an indication of the amendments made, excluding those made for compliance with the law or which are UK specific issues, which the IASB might like to consider for its revision of the IFRS for SMEs.

Those amendments that have been highlighted are as a result of changes in the scope of the standard.

Amendment	**Guideline**			
	a)	**b)**	**c)**	**d)**
Scope				
Elimination of public accountability		✓		
Cross-references to IFRS 8 and IAS 33 for listed entities.				✓

Amendment	Guideline			
	a)	b)	c)	d)
Definition of a financial institution				✓
Inclusion of public benefit entities		✓		
Presentation				
Statement of changes in equity	✓			
Consolidated financial statements				
ESOPs		✓		
Subsidiaries held exclusively for resale, including in an investment portfolio	✓			
Changes in stake and gains or losses on disposals	✓			✓
Exchanges of businesses for interests in another business				✓
Financial instruments				
Disclosures required by financial institutions (might be considered an expansion of 11.42 for those entities)				✓
Treatment of loan covenants for determining whether an instrument is basic	✓			
Hedge accounting is permitted for a net investment in a foreign operation	✓			
Borrowing costs may be capitalised in certain circumstances	✓			
Public benefit entities can account for concessionary loans at transaction amount		✓		
Fair value option	✓			
Financial guarantee contracts		✓		
Property, plant and equipment				
Revaluation	✓			
Intangible assets				
Capitalisation of development costs	✓			
Revaluation after initial recognition	✓			
Business combinations and goodwill				
Permit merger accounting for combinations under common control			✓	
Permit merger accounting by public benefit entities		✓		
Leases				
Clarify definitions				✓
Clarify scope for ‘arrangements that contain a lease’				✓
Liabilities and equity				
Clarification of whether an instrument is a financial liability or equity in certain circumstances.				✓
Only disclosure required for non-cash distributions to owners.		✓		

Amendment	Guideline			
	a)	b)	c)	d)
Grants				
Introduction of accrual method as an option for accounting for government grants.	✓			
Share-based payment				
Clarification that option pricing models are not required particularly for unquoted shares.				✓
Share-based payments granted by another group entity				✓
Employee benefits				
Presentation of the cost of a defined benefit pension is consistent with IAS 19's 2011 amendments.		✓		
Recognition of liability by entities in multi-employer schemes with a schedule of funding for a deficit				✓
Income tax				
Timing differences plus approach		✓		
Revised disclosure requirements		✓		
Related party disclosures				
Disclosure exemption for wholly-owned entities			✓	
Specialised activities				
Agriculture – permit historical cost model for biological assets and agricultural produce		✓		
Extractive industries – align with IFRS 6	✓			
Service concession arrangements – grantors		✓		
Service concession arrangements – operators				✓
Retirement benefit plans		✓		
Heritage assets		✓		
Funding commitments				✓
PBE – incoming resources from non-exchange transactions (including performance-related conditions and restrictions)		✓		

Appendix C

This sets out the FRC's comments in relation to the general questions, in addition to relevant comments made in the covering letter.

Part B: General questions

G4: Do you have any comments on the IFRS Foundation's IFRS for SMEs training material available?

The IFRS Foundation's IFRS for SMEs training material appears to include some useful material, and FRC staff have considered it when addressing requests for clarity in the UK standard. However, we note that in some areas (eg arrangements containing a lease) the training material effectively requires knowledge of the requirements of full IFRS in order to successfully apply the IFRS for SMEs.

This implies that the IFRS for SMEs is not a standalone document if it cannot be applied without reference to full IFRS.

G6: Use of IFRS for SMEs in your jurisdiction:

- **Is the IFRS for SMEs currently used in your country/jurisdiction?**
- **If the IFRS for SMEs is used in your country/jurisdiction, in your judgement what have been the principal benefits of the IFRS for SMEs?**
- **If the IFRS for SMEs is used in your country/jurisdiction, in your judgement what have been the principal problems with implementing the IFRS for SMEs?**

The IFRS for SMEs has not been endorsed for use in the EU, and therefore is not used directly in the UK. However, the FRC is finalising new accounting standards for the UK and Republic of Ireland that are based on the IFRS for SMEs. We have set out the benefits of all UK and RoI entities using an IFRS-based accounting framework in our [Revised draft] Consultation Stage Impact Assessment accompanying FRED 48, which was published in January 2012. This includes improvements in accounting and reporting of financial instruments, a succinct framework which is easier for preparers to use and maintain familiarity with, and periods of stability between three-yearly updates reducing education and training costs.

The principal potential implementation problems that have been highlighted by respondents to our consultations have been addressed through the amendments made to the IFRS for SMEs in developing the UK accounting standard, as set out in Appendix B.