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EXPOSURE DRAFT: Proposed amendments to International Financial Reporting Standard for Small and Medium-sized Entities (IFRS FOR SMEs ED/2013/9)

Dear Sir/Madam:

The International Federation of Accountants (IFAC) values the opportunity to comment on the Exposure Draft *IFRS for SMEs* (the ED) issued by International Accounting Standards Board (IASB).

IFAC is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of 179 members and associates in 130 countries and jurisdictions, representing approximately 2.5 million accountants in public practice, education, government service, industry, and commerce.

This response has been prepared following consultation across our broad constituent base; recognizing that some of IFAC's stakeholders may have different views on the issues presented below. It is relevant to note that IFAC's Small and Medium Practices Committee[1] contributed significantly in preparing this response, given their specific expertise in dealing with Small and Medium-sized Entities (SMEs).

IFAC believes that the *IFRS for SMEs* (the standard) has the potential to promote consistency and rigor in the financial statements prepared by SMEs. Through its Statements of Membership Obligations, IFAC requires its members to encourage responsible parties to consider the use of IFRS for SMEs for non-public interest entities, as the basis for preparing financial statements.

A robust and clearly defined reporting framework is a key factor affecting the provision of quality assurance on financial reports and enhances the credibility of the information reported. It is worth noting that the SMEs continue to experience difficulties securing debt financing and standardized financial information is critical to credit providers assessing their credit worthiness[2]. In our view, the standard could play an even greater role in providing relevant financial information and it is important for the IASB to give particular regard to

1 See http://www.ifac.org/about-ifac/small-and-medium-practices-committee

2 Bain & IIF (2013) *Restoring Financing and Growth to Europe's SMEs*

the needs of credit providers as an important user group of general purpose financial statements prepared by SMEs.

As a general principle, we support the IASB's approach to limit the options available in the standard and, as noted in the Basis for Conclusions, entities that apply the standard generally prioritize simplified accounting and do not require complex policy options. IFAC also considers that consistency and simplicity yields benefits to users in making financial reporting by SMEs more understandable and comparable. However, we do not think that options should be entirely ruled out, provided the IASB can demonstrate a compelling case that an option will provide more relevant information to users of the financial statements while still having regard to the cost constraint.

We are pleased to note that in its review of the standard, the IASB has been guided by its objective to maintain the simplicity of the requirements and to minimize the undue costs and efforts for preparers. IFAC supports the IASB's efforts to maintain the relative simplicity of the standard and appreciates that it is difficult to strike a balance between satisfying the needs of users of financial statements and minimizing the cost burden on preparers. We believe there is merit in the IASB explaining how it has balanced its objectives of simplification and cost minimization against the information needs of users—accepting that they are likely to have particularly diverse needs given the range of entities that apply the standard. Additionally, it would be helpful for the IASB to demonstrate how it has arrived at its assessment that the "undue cost and effort" exemptions in the standard do not compromise the quality of financial reporting. Indeed, we suggest that the standard might require an entity to provide an explanation in the notes to explain why it has elected to apply an exemption. Such transparency is useful for users of the financial statements to understand the judgments made by management in arriving at the conclusion that the expected user group will not be materially affected by the absence of such information.

As a basic standard-setting principle, we think that the concepts that underpin IFRSs and *IFRS for SMEs* should be the same, notwithstanding that their application may need to be modified to address user needs and the capacity constraints of SMEs. Having differences between the concepts that underpin the two sets of standards adds to complexity and potentially impairs the understandability of the financial statements. In our view, that does not mean that it is simply a matter of testing concepts under full IFRS and then summarizing them in the *IFRS for SMEs.* There is a need for a more robust assessment of how those concepts should be applied and whether they lead to appropriate reporting outcomes for SMEs. For example, we think it is important that the SME community is appropriately considered and engaged throughout the Conceptual Framework project. IFAC believes that once the Conceptual Framework is finalized, it is important that the IASB does not merely seek to incorporate it into Section 2 *Concepts and Pervasive Principles* but that the applicability of those concepts for financial reporting of SMEs is researched and debated. That process of engagement will take some time and it should not be constrained to the period of the next formal review of the standard—as that will leave insufficient time for those in the SME community to fully consider the implications of the revised concepts.

Our detailed responses to the questions in the ED are set out in the Appendix.

Please do not hesitate to contact me should you wish to discuss any of the matters raised in this submission.

Yours sincerely,

Fayezul Choudhury
Chief Executive Officer

APPENDIX

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?

As we noted in our response to the Request For Information (RFI), IFAC is of the view that the IASB should provide a general description of the entities for which *IFRS for SMEs* is written along with a range of factors for jurisdictions to consider in determining whether—and for what entities—to adopt and implement the standard. For example, those factors may include: the objective of SME financial statements; the key stakeholders impacted by entities’ activities and their information needs; and the need to use the complete *IFRS for SMEs* when prescribing their use. As noted in the Basis for Conclusions, jurisdictions can already incorporate the *IFRS for SMEs* into their local GAAP if they wish to allow certain publicly accountable entities to use it. However, those entities that use it would be complying with local GAAP and not with the *IFRS for SMEs*. A general description of those entities for which the standard was designed for would assist jurisdictions in deciding the appropriateness of applying it for various entities – particularly those that are publicly accountable.

The IASB should consider clarifying the definition of "public accountability” by incorporating the interpretation of "traded in a public market" contained in IASB's SME Implementation Group Q&A 2011/03 in the standard itself to augment the guidance currently provided.

In terms of the definition of “fiduciary capacity”, it would be helpful for the IASB to clarify the key factors management need to consider in establishing whether an entity’s fiduciary activities are incidental to its primary business. While the existing examples in paragraph 1.4 of the standard are instructive, they are not particularly useful in making the judgment required. It would be more helpful to explain why the fiduciary activities of entities such as real estate agents and schools typically do not satisfy the second limb of the definition of public accountability.

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?

We support the proposed changes to Section 29 *Income Tax* to achieve consistency with IAS 12 *Income Taxes*. This is a good example to illustrate the importance of establishing requirements in IFRSs before they are included in the IFRS for SMEs. Please see our response to Question 4.

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.

We have no specific comments to make on the other proposed amendments.

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.

In IFAC's view, the framework established by the IASB to align the *IFRS for SMEs* with new and revised IFRSs needs further consideration. While the principles set out in BC30 address the mechanics and timing of incorporating new and revised IFRSs, greater attention needs to be given to assessing the relevance and appropriateness of applying those changes to the *IFRS for SMEs.* As the standard is intended to be a standalone set of reporting requirements, then it follows that it is not just a matter of staggering and simplifying new and revised IFRSs. It is important to evaluate whether those changes are warranted given users' needs and the nature of financial reporting by SMEs. It remains unclear to us how that process of evaluation and tailoring will work and what evidence the IASB will draw on to make those judgments.

In terms of timing, we do not necessarily agree that the publication of an IFRS is the point at which applicability to the *IFRS for SMEs* should be considered. We think that, in most cases, application experience will need to be gained with new IFRSs before they are considered for inclusion in the *IFRS for SMEs*. IFRS 10 *Consolidated Financial Statements* and IFRS 13 *Fair Value Measurement* are good examples of where interpretation issues need to be resolved in the context of full IFRS before consideration is given to applying these standards to the *IFRS for SMEs*. Accordingly, it may be necessary to wait until a post-implementation review is conducted on new standards before considering their application to SMEs. We are concerned that it will be difficult for the IASB to make this assessment when an IFRS is published because it will lack the necessary evidence to establish whether or not the standard is achieving the intended financial reporting outcomes. As we noted above, it is important that the applicability of new IFRSs is carefully evaluated by the IASB to establish their relevance to financial reporting by SMEs. In IFAC's view, given that the *IFRS for SMEs* is a standalone set of reporting requirements it follows that there should be a separate due process to consider the applicability of new requirements for SMEs and to engage with the SME community of users and preparers. Similarly, the SME community needs sufficient time to transition to any new requirements and because of resource constraints it is likely that they will need a longer lead time than for those that apply for full IFRS.

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?

IFAC agrees that, as a general principle, changes in accounting standards should be applied retrospectively to ensure users are able to make inter-period comparisons. However, the proposed changes to Section 29 *Income Taxes* are likely to require some entities to carry out a reassessment of recognition, measurement and disclosures of deferred tax items. This may be particularly burdensome for some SMEs without a compensating benefit to users of their financial statements. For that reason, we suggest that the IASB offers some relief to entities in applying the changes to Section 29 retrospectively—perhaps through the "undue cost or effort" exemption. As we noted above, where that exemption is used, entities might be best required to provide an explanation of how they arrived at their judgment that complying with the requirement would have been particularly burdensome.

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?

In IFAC's view, given that the proposed amendments to the standard are relatively minor, there is no reason to significantly delay when the amendments to the standard become effective. That said, even minor changes will require entities to review their accounting policies, collect appropriate data, and make necessary changes to their financial statements. Accordingly, the effective date should be at least one year from the date the revised standard is issued. IFAC supports early adoption being permitted for those entities that elect to adopt the standard before its effective date.

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?

The IASB has noted in the ED that there is some support for moving to a less-frequent review of the standard, with the possibility of a five-year review cycle. IFAC agrees that it is important that the standard remains as stable as possible because, as we noted above, many of the entities that apply it lack the resources to deal with frequent and significant changes to reporting requirements. In the current review cycle, the IASB has made only relatively minor changes to the standard pending gaining experience with the operation of new standards or the completion of major standard setting projects. IFAC supports that approach and it is important that experience is gained in interpreting and applying new IFRSs before they are included in the IFRS for SMEs standard.

The IASB's major projects on revenue recognition, financial instruments, leases, and the conceptual framework will potentially impact the requirements in *IFRS for SMEs*. For this reason, we suggest that it would be appropriate for the IASB to start looking at potential implications of these projects for those entities that use the standard. We believe that the process of gathering information about the effects of new requirements on both preparers and users should ideally begin before the formal review period for changes proposed to the *IFRS for SMEs* commences, otherwise there is a risk that new IFRS requirements are just "grafted" onto the standard without sufficient understanding being developed of the impact for SMEs and the users of their financial statements. This would potentially undermine the "standalone" nature of the standard and the coherence of SME financial reporting against it. In our view, these considerations are more important than establishing an arbitrary review period of three or five years.

Question 8 - Any other comments

Do you have any other comments on the proposals?

We have no further comments to make on the proposals to amend the standard.