November 30, 2007

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By Email: CommentLetters@iasb.org

Dear Paul,


INTRODUCTION

1. The International Federation of Accountants (IFAC) welcomes the opportunity to comment on the exposure draft (ED) of International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) published for comment in February of this year by the International Accounting Standards Board (IASB).

2. IFAC is wholly supportive of the IASB in its quest to develop high quality global financial reporting standards and to promote international convergence of these standards. The ‘Wong Report’\(^1\) commissioned by the IFAC Board in 2004 identified widespread concerns as to the relevancy and appropriateness of International Financial Reporting Standards (hereafter referred to as full IFRSs and taken to mean the entire body of standards issued by the IASB and its predecessor) to SMEs. This concern has continued to increase over the past few years.

3. A great many jurisdictions, especially developing nations, look to the IASB to develop a high quality principle-based SME standard. Such a standard has the potential to eliminate the need for, as well as to replace, national and regional GAAPs. This will harmonize accounting practices for millions of entities worldwide and in so doing ensure consistent high quality reporting at reduced economic cost. IFAC, therefore, welcomes the IASB’s initiative to develop an IFRS for SMEs.

4. IFAC acknowledges the very considerable progress made on this important project. The ED is a high quality document and, subject to making some significant changes to its structure and substance along the lines suggested in this letter, should provide a sound basis for SME financial reporting. In particular, we feel that to achieve an

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\(^1\) ‘Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs’, September 2004.
optimal cost-benefit outcome for most SMEs further simplification is needed. While we make various suggestions for improvement IFAC is keen to see a final standard issued as soon as is practicable and so would prefer to avoid re-exposure of the proposals. Hence, we would be willing to accept some changes proposed in this submission not being accepted if that would lead to a timely release of a final standard provided the field test results were generally positive. Subsequently, the standard can be reviewed and changed as necessary.

5. We are generally satisfied with the way the IASB has approached this project. The approach taken has been deliberate, considered and consultative. The IASB has actively engaged with a broad range of interested parties so as to help ensure that the eventual standard reflects the combined counsel of all relevant constituents. IFAC has participated fully in the various consultation exercises and is pleased to offer its views and suggestions on the ED as set out below.

6. We believe the field tests will yield the most convincing evidence regarding the appropriateness of the proposed standard. When analyzing the comment letters and field test results we suggest that the IASB stress the latter. The IASB should be prepared to be persuaded by this evidence above all else, provided of course the field tests are sufficiently representative and rigorous.

7. This submission is organized into four parts. First, the basis for this submission is described. Second, general background issues are presented, including the principles underlying the specific responses. Third, the key points arising from our submission are highlighted. Finally, the detailed responses to the 11 questions raised in the ED are set out in sequential order in the Appendices 1 to 11.

**Basis for this Submission**

8. The views expressed in this letter represent the general views of IFAC as an organization. Compiling a single IFAC response that wholly satisfies all of its constituents is impracticable owing to the diversity of these constituents. Not surprisingly, the views expressed by constituents varied, often reflecting a particular national stance. Therefore, when formulating its views, IFAC has sought to take a global, public interest perspective. This perspective may not always be consistent with individual national laws, regulations and interests.

9. The IFAC Small and Medium Practices (SMP) Committee has played the lead role in developing this submission. This committee comprises members and technical advisors with extensive experience preparing SME financial statements; their combined experiences provide the authority to support the comments. The submission has benefited from the insights of the Developing Nations Committee (DNC). Together the members of the SMP Committee and DNC come from 27 IFAC member bodies drawn from 26 countries spanning all regions. Finally, staffs supporting the International Ethics Board for Accountants (IESBA) and the International Auditing and Assurance Standards Board (IAASB) have also provided input.

10. We have sought to promote active and constructive consultation and research aimed at helping the IASB obtain an optimal outcome. We have encouraged our member bodies to respond to the ED, undertake field tests and participate in IASB
roundtables. We have also conducted our own research into the users and preparers of micro-entity financial reports. This research, described below, has helped inform some of the points made in this letter.

11. It should be noted that in various instances the views we express in this comment letter differ from those we expressed in the response to previous IASB invitations to comment. These changes of view have resulted from new information coming to our attention including evidence obtained through consultation and research. Finally, as noted above, we believe the most persuasive evidence to be the field test results. These results should take precedence over our comments to the extent they contradict.

GENERAL ISSUES

Public Interest

There is a compelling public interest case for the introduction of an SME accounting standard.

12. IFAC sees a considerable public interest benefit to the introduction of the IFRS for SMEs. While we recognize the benefit of enabling investors to compare SMEs' financial performance across international boundaries on a consistent basis we believe the benefits go far beyond facilitating international comparisons. The standard should also greatly improve the quality of SME financial reporting, providing in a cost effective manner the financial information users require to make informed decisions. An internationally accepted approach to reporting by SMEs will also bring credibility to their financial statements: users will take comfort from the fact that they conform to high quality standards. An SME standard will also foster greater financial discipline and transparency. Ultimately, the public interest will benefit from: a reduction in the cost of capital for SMEs; a more efficient allocation of capital; the effective exercise of business ownership and supervision of management’s stewardship; and even the prevention of fraud.

13. An IFRS for SME is likely to elicit a higher level of voluntary compliance, and hence convergence, with international accounting standards than full IFRSs alone. Full IFRSs pose significant implementation challenges, especially for SMEs and less developed nations. This inhibits voluntary compliance and proper enforcement is often impractical or ineffective.

14. IFAC and our member bodies look to the IASB to issue SME standards. The IASB is held in high regard as a standard setter and as such its SME standard will automatically assume considerable authority in the eyes of regulators and influential international organizations. Many regulators will unquestioningly adopt the standard verbatim. Hence, it is vital that every effort is made to ensure an optimal outcome.

Research

The most persuasive evidence when determining the likely suitability of the proposed standard is the field testing.

15. The most important input to the derivation of a high quality SME standard is systematic and rigorous research into the subject matter. Ideally the standard needs to be based on evidence from a representative sample of users and preparers drawn from
around the world. Accordingly, we believe the field tests to be the most persuasive evidence as to the suitability of the proposed standard.

16. We hope that our own micro-entity financial reporting research will also provide useful evidence. This project comprised two phases. The first phase of desk-top research culminated in the release in December 2006 of an information paper entitled *Micro-Entity Financial Reporting: Perspectives of Preparers and Users*[^2], which included a review of the existing research on the topic, a survey of the legal status of micro-entities in different countries, and the various definitions that exist in different jurisdictions. The second phase comprised focus group interviews and surveys of users and preparers of micro-entity reports in Kenya, Italy, Poland, the United Kingdom, and Uruguay to test whether the proposed IFRS for SMEs was likely to meet the needs of users of financial reports of micro-entities as well as sufficiently ease the burden on preparers. In addition to the findings being used to inform this response letter, the research findings will be summarized into an IFAC SMP Committee Information Paper for publication in the coming weeks.

*Ex Post Regulatory Impact Assessment*

*An in-depth post-implementation review should be conducted*

17. While a workable SME standard is needed sooner rather than later we suggest that once issued research be ongoing. In particular, we strongly encourage the IASB to undertake a thorough review of the implementation of the eventual standard as part of the exercise to update the standard. We note that the Trustees of the IASB have already sanctioned the use of such reviews for all new IFRSs. This post-implementation review should include comprehensive research into the views of preparers, users, and other stakeholders. Cost-benefit is a universal issue but is especially relevant in the context of SMEs.

*Applicability*

*While there is a strong case for a global SME accounting standard the proposed standard is geared more towards medium and larger unlisted entities*

18. While we believe there is a strong case for a global standard tailored to SMEs we recognize the difficulty of deriving a standard suitable for application by such a broad constituency as all non-publicly accountable entities (NPAE) that produce general purpose financial statements (GPFS) for external users.

19. Unfortunately, the proposed standard seems geared more towards medium and larger unlisted entities. As a consequence it may prove ill-suited on cost-benefit grounds for application by the great majority of small entities that produce GPFS for external users, especially those operating in developing nations. We are open to being convinced otherwise by the field tests.

*Micro-entities*

*The standard should explicitly exclude from its scope those entities for which GPFS cannot be justified on cost-benefit grounds*

20. Even very small entities will have some customers, employees and suppliers and as such potential external users of its financial statements. We believe, however, that the proposed standard should not apply to those entities that have so few external users that the production of GPFS would not be justified on cost-benefit grounds. Such entities will produce financial statements solely for the use of owner-managers and/or for tax reporting and/or non-operating group companies founded for legal or tax purposes. For these entities special purpose financial reports tailored to meet the specific information needs of a particular user should suffice.

21. While it is for national jurisdictions to determine the precise scope of the standard the scope as described in the current draft risks inadvertently being taken to include such micro-entities. We suggest, therefore, that the standard explicitly exclude those entities for which GPFS can’t be justified on cost-benefit grounds. Of course this must be a decision made by each jurisdiction rather than the reporting entity.

**Primary Considerations**

_For the standard to be stand-alone, succinct and simple we suggest eliminating cross-references, omitting some material, further simplifications, and some restructuring_

22. IFAC believes the standard should exhibit three primary characteristics: self-contained, succinct, and simple. These characteristics should ensure that preparers will find it easy to understand and easy to implement and hence conducive to the production of SME financial reports in a cost effective way. Generally these characteristics are complementary but where they do conflict – stand-alone may occasionally demand more text – we feel an appropriate balance can be struck.

23. The standard needs to contain guidance sufficient to cater for the vast majority of events and transactions typically faced by an SME. For this reason we are pleased to see the elimination of the mandatory fallback. We welcome SMEs having to find answers within the standard by analogy or by using pervasive principles following the hierarchy in paragraphs 10.2-10.4. There may be some rare instances where an entity is unable to determine a suitable treatment on the basis of analogy or application of the pervasive principles. Such entities may choose to refer to the full IFRS as suggested in paragraph 10.4.

24. For the standard to be truly stand-alone necessitates elimination of all cross-references to full IFRSs. Simplicity and succinctness could also be improved by removing material relevant to a small minority of SMEs, further simplifications, and some restructuring. We elaborate on these later.

**Conceptual Framework**

_While the basis for the standard is, appropriately, the Framework, the standard should include a suitably abbreviated comprehensive SME version of the Framework_

25. We agree that the basis for the ED is the IASB Framework for the Preparation of Financial Statements (Framework). The ED, largely within Sections 1 and 2, contains some, but not all, of the elements of a conceptual framework for SME

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3 Since the IASB project to revise the Framework is likely to be completed after the SME standard all references in this paper are to the existing Framework.
financial reporting. For the standard to be truly stand-alone we suggest it includes a suitably abbreviated comprehensive SME version of the *Framework*. We suggest, therefore, the following: consolidating all conceptual material into one section; ensuring compatibility with the key terminology and definitions, content, and overall structure of the *Framework*; and adapting this material along the lines suggested in paragraphs 26-40.

*Objectives of SME Financial Reporting*

**The objectives of SME financial reporting should recognize the dual and overlapping roles of decision-usefulness and management stewardship**

26. While IFAC agrees with the decision-usefulness objective of the IFRS for SMEs in Section 2 we feel it is important that the objective recognizes the dual roles of financial reporting, those of decision-usefulness and management stewardship.

*User Needs*

**The standard needs to clarify the users and their information needs**

27. We question whether the ED sufficiently clarifies users of SME financial statements and their information needs. We suggest, therefore, that the text relating to users and user needs in the *Framework* be appropriately extracted and adapted, based on the text in BC 24 and BC 55, the observations of respondents and, most importantly, the field test results, for inclusion in the IFRS for SMEs.

28. We broadly agree with the users and their needs as set out in the ED and the Basis for Conclusions. We have a few observations. While the users of SME financial statements are likely to be similar to those of larger entities, the primary users may differ and some users may be absent altogether. Furthermore, the information needs of a particular user may differ in focus from their larger listed entity counterpart.

29. While the main group of external users of a larger listed entity is likely to be existing and potential investors with little if any direct engagement with the entity, for an SME it is likely to be creditors. These users tend to focus on the ability of the entity to generate sufficient operating cash flows to meet short- and medium-term liabilities as they fall due. Our micro-entity research corroborates this.

30. Many SMEs are family owned and/or controlled. These owners can typically gain direct access to internally generated information and so do not rely upon published financial reports. IFAC notes much of the complex, and hence costly, requirements within full IFRSs, such as those in IAS 39, are primarily intended to support investment decisions in the capital markets.

31. In addition, investors in larger listed entities often use analysts to systematically interrogate financial statements on their behalf. These analysts are sophisticated and accordingly have an appetite for a large and complex set of data that they use for predictive purposes. These users and their accompanying demand for complex analysis are largely absent in an SME context.

32. For many SMEs there is a strong cost-benefit case for having a form of reporting that simultaneously serves both external users and management. Meanwhile, the wider public is likely to be less concerned about the activities of any one SME.

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33. The above observations provide the overriding rationale for having differential accounting standards, each tailored to the primary users and preparers of the respective target entities. Moreover, since the IFRS for SMEs is specifically designed for use by non-publicly accountable entities it may be appropriate for Section 1 to explicitly exclude publicly accountable entities from its scope (thereby necessitating that paragraph 1.3 is eliminated) while also stressing that it has equal status to full IFRS.

34. We expect that the field test results will provide the most compelling evidence as to the primary users of SME financial statements and the kinds of decisions these users make. We also suggest that as part of the post-implementation review above the IASB appraise the extent to which user needs are satisfied by financial statements produced using the SME standard.

**Qualitative Characteristics and Pervasive Principles**

**The standard should adopt the same set of qualitative characteristics as the Framework while adopting a different measurement basis to that for full IFRS**

35. We note that the qualitative characteristics and constraints in the ED differ from the Framework. We believe that the SME standard should share the same set of qualitative characteristics and constraints as in the Framework. Indeed, this similarity underpins international convergence in financial reporting between entities in different countries and between different size companies in the same country. Hence, we suggest the SME standard include the same qualitative characteristics and constraints as the Framework, albeit with the explanatory text suitably tailored to SMEs and the cost-benefit criterion elevated to being the overriding objective.

36. We believe, however, that differences in the users and their information needs will lead to different levels of importance attaching to each of these qualitative characteristics. These differences provide the rationale for some differences in the pervasive recognition and measurement principles from those used in full IFRSs. Since the ED adopts largely the same principles as full IFRS further changes may be needed. While we concur with the criteria (paragraphs 2.24-2.27) and its application to the elements (paragraphs 2.34-2.39), there may be a case for some refinement to the measurement basis. We elaborate on this in paragraphs 53-61.

**Cost-Benefit**

**Cost-benefit should be the overarching objective for all financial reporting**

37. The main reason full IFRSs are ill suited for SMEs is that often the compliance costs exceed the benefits. Indeed cost-benefit is the primary rationale underpinning many of the modifications we propose making to the ED. Because this criterion should, in principle, be met by all regulations, we suggest it be elevated to the status of overarching objective, rather than simply a constraint, when determining the form and content of all financial statements. In the absence of a cost-benefit test any level of user needs, no matter how insignificant, would justify the production of information.

38. ‘Costs’ are taken to mean the costs of preparing, disseminating and using/interpreting the financial statements and ‘benefits’ to be the value of the information contained within the financial statements to the end user. Whereas for larger listed entities it
may be argued that the benefits from using financial statements prepared on the basis of full IFRSs exceed costs, for many SMEs the costs outweigh the benefits.

39. We believe that the cost-benefit criterion can justify having more than one set of accounting standards as well as different measurement rules pertaining to different classes of assets and liabilities. In effect cost-benefit is used to justify having different measurement bases between large and small entities and between different classes of assets and liabilities.

40. We agree with the IASB that a key objective of the SME standard is to significantly reduce costs by having a simpler standard than full IFRSs. We also note that the standard already embraces the notion of cost-benefit in some respects. For example, in many cases a requirement is not binding where it is “impracticable” as well as the use of the concept of “readily determinable without undue cost or effort”. We would, however, prefer to see greater emphasis given to cost-benefit considerations in the standard. We believe that cost-benefit should be the central objective and that this can be effected both through simplification of the requirements as well as increased use in selected instances of the notions of “impracticability” and “readily determinable”.

Conclusion

For an optimal cost-benefit outcome for most SMEs further simplification is needed

41. Despite drafting the standard while having in mind an SME with “about 50 employees”, an objective we agree with, we believe the resulting ED to be skewed in favor of entities with considerably more than 50 employees. IFAC believes that if the standard is to deliver an optimal cost-benefit outcome for the vast majority of SMEs then further simplification of the ED is needed.

42. Outlined in this submission are a number of suggestions, including a package of additional simplifications, that we believe will result in a stand-alone, succinct, simple and relevant standard that will provide in a cost effective manner the users of SME financial reports the information that they need. Nevertheless, these suggestions are contingent upon the outcome of the field tests. As we mention above these should be taken as the most persuasive evidence and override any comments made in this or other comment letters.

KEY POINTS

43. The Appendices 1-11 set out the detailed responses to the eleven questions contained in the invitation to comment. It should be noted that our response concentrates on what we consider to be the most important issues and on those where we disagree with the IASB. The following paragraphs summarize the key points reflected in our detailed comments.

Scope

The standard should be directed at entities of limited public interest with “public interest” determined by local regulators

44. IFAC concurs with the IASB in not providing a specific ‘bright-line’ description of the class of entity for which the proposed IFRS for SMEs is intended. We recognize
that precise scope definitions are best made at national level so as to ensure compatibility with the local circumstances.

45. We suggest that full IFRS be aimed at ‘entities of significant public accountability’, while IFRS for SMEs is directed at ‘entities of limited public accountability’. While we see merit in individual jurisdictions interpreting public accountability in the broadest sense, including the entities’ social and economic impact and any fiduciary role, we would prefer that the local regulators determine this for themselves. Accordingly, we propose that entities of significant public accountability comprise:

1. All private sector listed entities and government business entities; and
2. Entities which have been designated by a regulator to be subject to the same financial reporting requirements as those applicable to a listed entity. Factors which the regulator would consider in making the determination would include:

   (a) Size relative to the economy;
   (b) Social significance in a particular jurisdiction; and
   (c) Whether the entity holds assets in a fiduciary capacity.

The standard may need to provide clarification, possibly in the Glossary, as to what is meant by “fiduciary”. The inverse of the above definition would effectively define entities of limited public interest and as such serve to positively define those entities that should apply the IFRS for SMEs.

46. We believe that larger unlisted entities might better be included the scope of full IFRSs, in turn leaving scope to push the target range of entity size lower, as well as ensure more consistent application of the public accountability principle from country to country. But it should be left to the discretion of the respective jurisdiction which set of accounting standards is deemed appropriate for which kind of entity, bearing in mind the specific circumstances in that jurisdiction. Whether or not this revised definition is adopted the IASB ought to consider whether the label IFRS for SMEs is appropriate. IFRS for Private Entities may be a better description.

Cross-References – Options

To achieve a self-contained standard cross-references to options should be eliminated

47. The proposed IFRS for SMEs includes a number of optional treatments similar to those provided in the full IFRSs. We support the elimination of options except where they provide an opportunity for an optimal outcome through the exercise of professional judgment. Many options in full IASs are a legacy of compromises made during their development. Moreover, SMEs may be confused by the choice; they often look to a standard to clearly recommend the most appropriate treatment.

48. Where there is strong case for keeping the options we disagree with providing the simpler option in the standard and then cross-referencing the options to the relevant paragraphs of the full IFRS. Cross-referenced options can present practical problems. For example, while the IFRS for SMEs will be static for a period of time full IFRSs will continually evolve. As a result cross-referenced text may change and so become obsolete. Second, the options, irrespective of whether they are cross-referenced or
incorporated directly within the text of the IFRS for SMEs, add volume and complexity to the standard. Finally, and most importantly, cross-references to other sources undermine the objective of a stand-alone SME standard; our research indicates that SMEs much prefer to seek a solution within the SME standard.

49. Hence, we suggest elimination of all such cross-references and either elimination of the option altogether or the inclusion of the option within the SME standard itself. Outright elimination is recommended for topics which we consider relate to a small minority of SMEs and/or for many options relating to the use of revaluation or fair values. For all other topics we suggest inclusion of the option within the standard itself by replacing the cross-references with a simplified version of the corresponding provisions in the full IFRS within the main body of the SME standard.

Cross-References - Topics Not Addressed

To achieve a self-contained standard cross-references for topics not addressed should be eliminated

50. As with cross references for options we suggest removing all cross-references to full IFRSs for topics not addressed in the IFRS for SMEs so as to achieve the objective of a stand-alone standard. Topics relevant to SMEs should be included within the SME standard itself while those that are not should neither be included nor referred to specifically at all.

51. Outright elimination of cross-references for topics not addressed is recommended for those topics which we consider relate to a small minority of SMEs. In such cases the hierarchy in paragraphs 10.2-10.4 provides sufficient guidance. For topics considered relevant we suggest replacing the cross-references with a simplified version of the corresponding provisions in the full IFRS within the main body of the SME standard.

52. In due course, if a compelling case is made for a topic’s inclusion then the IASB should consider its inclusion in an updated edition of the IFRS for SMEs. Indeed, consideration of the inclusion of a topic should be part of a post-implementation review.

Measurement Basis

More emphasis needs to be placed on the use of historic cost as the measurement basis

53. We believe that the appropriate basis for measuring some SME assets and liabilities is different from full IFRSs. While full IFRSs focuses on fair value, the IFRS for SMEs should adopt simplified measurement principles centered more on historic cost.

54. We cite various reasons for reduced emphasis on fair values. First and foremost, fair value data is often more difficult and costly to obtain and disseminate than historic cost. In the context of SMEs this is more likely to result in costs outweighing benefits. This is exacerbated by the fact that SMEs often face greater difficulty than larger entities when making fair value measurements. For example, SMEs operating in jurisdictions with less developed capital markets will often lack access to the observable market data necessary to determine fair values. Consequently, in certain cases SMEs may have to resort to “valuation techniques” to determine suitable estimates. These estimates will lack the reliability of fair values based on observable
prices. Indeed, a recent IASB Discussion Paper, *Measurement Bases for Financial Reporting – Measurement on Initial Recognition*, proposes employing alternative measurement bases where fair values can’t be measured reliably. It should also be noted that resort to estimation techniques poses practical difficulties for SMEs which again pushes up the costs relative to the benefits.

55. Second, for larger listed entities one of the key sources of demand for fair value data is investment analysts that typically use the data for predictive purposes on behalf of investors in the capital markets. These analysts are largely absent from the SME context.

56. Finally, many jurisdictions will face considerable practical difficulties implementing fair values owing to non-compatible national legislation. For example, legislation governing taxable and distributable profits often requires a historic cost measurement basis. While we agree that determination of taxable income and distributable income are not the primary objectives of the proposed IFRS for SMEs it would be cost effective for an SME if the standard was broadly compatible so as to reduce the complexity of deriving taxable income from reported income.

57. For the reasons outlined above IFAC believes that the primary measurement basis should be historic cost. While the ED focuses much more on cost than full IFRS still more emphasis on historic cost is needed. We have various suggestions – some general ones set out just below and specific ones in the appendices.

58. First, we encourage eliminating many of the options to use fair values as well as reducing the instances where fair values are required. These are specified in the appendices. We accept, however, that there are certain circumstances where the use of fair values is appropriate, for example when a non-current asset is impaired or where there is a liquid market and active market for certain assets.

59. Second, while we welcome the steps taken to ease the burden of using fair values by allowing SMEs to revert to using cost where fair values are not ‘readily determinable without undue cost or effort’, we suggest this concept, which implicitly embraces the notion of cost-benefit, could be applied in a few more selected instances.

60. Third, we do not believe that fair value be used as the default measurement attribute for financial assets and liabilities. Instead we suggest that the requirement to use fair value be confined to assets and liabilities that are ‘readily realizable’. We suggest two criteria be used to determine whether an asset/liability is ‘readily realizable’. First, fair value can be determined by reference to observable market data. Second, *either* the asset/liability can be realized in the market at any time without causing significant disruption or change to the entity’s operations *or* management is committed to a plan to dispose of the asset/liability and an active program to identify a buyer and execute a plan has commenced. It should be noted that derivatives would automatically fall within this definition of ‘readily realizable’.

61. Finally, we suggest for purpose of clarification that the pervasive recognition and measurement principles in paragraph 2.41 be changed so as to emphasize cost as follows:
After initial recognition, an entity generally measures financial assets and financial liabilities at cost or amortized cost unless this [draft] standard requires or permits measurement on another basis such as fair value.

Organization and Clarity

Restructuring will make the standard easier to understand and navigate

62. IFAC agrees with the idea of having one composite standard organized on a topic by topic basis using sections. However, we suggest that the structure could be improved in various ways to make it more logical and understandable and easier to navigate.

63. First, Sections 3-8, 10, and 32 and 33 as well as parts of Sections 24 and 30 could be merged into one section on ‘preparation and presentation of financial statements’. Second, the bulk of Sections 11-28 could be ordered so as to match the order that they appear in the model financial statements. This may better lend itself to a web-based version of the standard with hyperlinks built into the model financial statements taking readers to the relevant sections.

64. Third, the model financial statements could also indicate, perhaps through shaded text, those elements that relate to consolidation. In this way SMEs not required to produce consolidated accounts can readily identify what is relevant to them, the form and content of company accounts. In addition, Sections 9, 13, 14 and 18 as well as parts of Section 30 could be packaged into a section on ‘consolidated financial statements’, possibly near the end of the standard on account of it not being relevant to SMEs that have no subsidiaries. Furthermore, other sections that only apply to some SMEs, essentially Sections 25, 27, 29, 30, 31, 34, 35 and 37 to the extent we have suggested retaining them, could be packaged together at the end of the standard in a section titled ‘special considerations’.

65. We also question the need to have a derivation table. This gives the impression that the standard is, and will always be, simply a derivative of full IFRSs. While we can accept the SME standard being based on the same conceptual framework as that for full IFRS, preferably amended to make cost-benefit the overriding objective, we suggest its updating be driven by the need to provide guidance specifically tailored to SMEs as opposed to the need to be derived from full IFRS.

66. We are generally pleased with the clarity of the text. This should ease the process of translation and facilitate consistent implementation.

Implementation Guidance

Implementation assistance will be crucial to the acceptance and consistent application of the standard

67. Implementation assistance will be the key to the ultimate success of the project. Hence, it is crucial that there be coordinated action in support of implementation which might involve the IASB, IFAC and its member bodies, the firms and other interested parties.

68. The preparers of SME financial statements will find the existing implementation guidance - illustrative examples, model financial statements, disclosure checklists, and the Glossary - especially useful. We see merit in providing additional guidance in
certain areas, especially illustrative examples which demonstrate format and calculations. similar to that in the appendix to Section 20, to support individual sections such as those on leases, impairment, and financial instruments (for example, computation of “amortized cost” and “effective interest rate”). Supplementary guidance could be built up over time. Indeed, the post-implementation review could include an investigation into areas where guidance would be most useful.

69. We have two further suggestions. First, the model financial statements could be placed at the front of the standard as part of the section on presentation in the same way that IAS 1 contains sample financial statements. Second, the Glossary could be expanded so as feature certain items that are presently mentioned but not included.

Disclosure

Further reductions in disclosure requirements can be justified

70. IFAC welcomes the reduction in disclosure requirements. This will significantly reduce the volume of SME financial statements. Shorter financial statements will be more easily assimilated by users and will bring about a corresponding reduction in the reporting burden on SMEs. Simplification of the IFRS for SMEs, largely through elimination of options and modifications to recognition and measurement rules as described in Appendices 1 to 6, will result in even less disclosure requirements. Finally, in Appendix 9 we have identified a few other disclosure items which we consider to be of limited usefulness to typical SME financial statement users.

Transition Guidance

The proposed transition guidance is too restrictive

71. In the interests of maximizing acceptance of the IFRS for SMEs and ensuring the transition from another GAAP is cost effective it is crucial that the transition guidance is not overly restrictive. While we concur with the four exceptions proposed we believe that the listed exemptions are too restrictive. It remains unclear why certain exemptions provided by full IFRS (per IFRS 1.13 – 25(g)) are not incorporated in the ED. The requirements concerning cases where a subsidiary and its parent become first-time adopters at different points in time (per IFRS 1.13(f), IFRS 1.24-25) seem to us at least as relevant as the requirements adopted in paragraph 38.8(e) pertaining to share-based payment transactions.

72. We suggest, therefore, that there be a general impracticability exemption using the definition of impracticable in the Glossary (we take this, defined as ‘making every reasonable effort to do so’, to be set at a lower threshold than the one used in full IFRS which refers to ‘impossibility’). Wherever restatement will prove impracticable the SME should be permitted to retain the carrying amounts of assets and liabilities under its previous GAAP at the date of adoption.

Maintenance

The periodic updating should include a comprehensive post-implementation review

73. IFAC agrees with the proposal to periodically update the IFRS for SMEs. This has various advantages. It gives SMEs, and in particular preparers, the opportunity to get accustomed to the content of the standards and adept at applying them. Second, it
reduces the amount of administration around the maintenance of the standard as well as supporting materials developed by, for example, IFAC member bodies and commercial publishers/software houses. Third, it provides a chance to evaluate how changes work for publicly accountable entities and whether they are relevant to SMEs. Finally, and most importantly, it ensures that the evolution of the IFRS for SMEs is not dependent solely on full IFRSs.

74. The IASB proposes updating once every two years. We suggest that the first update, supported by a comprehensive post-implementation review, be undertaken after two years and thereafter be updated every three years. In addition, we suggest that just like individual IFRSs each updated version of the IFRS for SMEs has an effective date at least one full financial year after the date of issue so as to give SMEs adequate time to assimilate the new requirements.

75. Finally, we suggest the IASB consider forming a permanent structure, perhaps a sub-committee of the full Board, be established to oversee the periodic updating. We also suggest that the source of updates not be restricted to amendments to full IFRSs. This committee could liaise annually with the existing SME Working Group.

CONCLUDING COMMENTS

76. IFAC regards this project as of utmost importance, possibly the most important on the IASB’s agenda. We are, therefore, highly supportive of this project. We also recognize the considerable progress made. The ED is a high quality document and with appropriate adjustments, largely on the basis of field test results, should provide a basis for sound SME financial reporting.

77. We also applaud the efforts being taken to ensure an optimal solution by canvassing the opinions of interested parties through roundtables, an extended public exposure process, and the facilitation of field testing. We see the field test results as especially crucial. These are the most compelling piece of new evidence regarding the suitability of the proposed standard. Accordingly, IFAC has vigorously encouraged its member bodies and others to participate.

78. The success of this project will ultimately rest on widespread adoption, which will be determined by a series of national or regional decisions, and consistent implementation. IFAC is committed to helping the IASB in whatever way it can to ensure these objectives are met. We hope that this response is useful.

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

Sincerely,

Ian Ball
Chief Executive
**APPENDIX 1: QUESTION 1 – STAND-ALONE DOCUMENT**

In deciding on the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and other events and conditions typically encountered by SMEs with about 50 employees. For such entities, the proposed IFRS is intended to be a stand-alone document, with minimal cross-references to full IFRSs.

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?

**RESPONSE**

See paragraphs 22-24 and 47-52 of the main body of the letter.

We do not believe that there are additional transactions, other events or conditions that should be covered in the proposed standard to make it more self-contained. We do believe, however, that some of the sections contain subject matter, some of it cross-referenced to full IFRS, that is only relevant to a small minority of SMEs.

Outright elimination of cross-references for topics not addressed is recommended for those topics which we consider relate to a small minority of SMEs. Sections we suggest as candidates for elimination from the IFRS for SMEs, including those which amount to simply a cross-reference to the full IFRS, together with reasons are explained in the table below. In due course, if a compelling case is made for a topic’s inclusion then the IASB should consider its inclusion in an updated edition of the IFRS for SMEs. For all other cross-references for topics not addressed topics we suggest replacing the cross-references with a simplified version of the corresponding provisions in the full IFRS within the main body of the SME standard.

<table>
<thead>
<tr>
<th>SECTION</th>
<th>RATIONALE FOR ELIMINATION</th>
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<tr>
<td>25 Share-Based Payment</td>
<td>While we believe share-based payments are rare for SMEs they are growing in popularity. Hence, we suggest retaining this section but simplifying the requirements. First, for equity settled share based payments SMEs should only be required to disclose the principal terms and conditions. In this way the cross-reference to IFRS 2 can be deleted. Second, when measuring the liability incurred in a cash-settled share-based payment transaction SMEs should be allowed to apply intrinsic value if the fair value of the liability is not readily determinable without undue cost or effort. This would eliminate the need for the cross-reference to IFRS 2.</td>
</tr>
<tr>
<td>31 Segment Reporting</td>
<td>Most SMEs will be relatively simple straightforward businesses typically with one business line operating in one geographical area. Hence, we suggest complete elimination of this topic from the</td>
</tr>
<tr>
<td><strong>34 Earnings per Share</strong></td>
<td>Disclosure of EPS is rarely required for SMEs. Generally its disclosure is required only for listed entities. Hence, we suggest complete elimination of this topic from the standard.</td>
</tr>
</tbody>
</table>
| **35 Specialised Industries** | **Agriculture**  
We welcome the steps taken to simplify the provisions for agriculture by requiring fair value only when it is ‘readily determinable without undue cost or effort’. We suggest, however, that the cross-references to IAS 41 be removed and a simplified version of the provisions be incorporated into the SME standard.  
**Extractive Industries**  
We suggest scoping this into the sections to which paragraph 35.3 refers.  
**Insurance**  
We see no need to explain why insurance is not part of the IFRS for SMEs as its scope is dealt with in Section 1. |
| **37 Interim Financial Reporting** | Interim reports are rarely required for SMEs. Only larger SMEs and/or those in certain jurisdictions are required to prepare them. Hence, we suggest complete elimination of this topic from the standard. |
APPENDIX 2: QUESTION 2 – RECOGNITION AND MEASUREMENT SIMPLIFICATIONS THAT THE BOARD ADOPTED

The draft *IFRS for SMEs* was developed by:

(a) extracting the fundamental concepts from the IASB *Framework* and the principles and related mandatory guidance from full IFRSs (including Interpretations), and

(b) considering the modifications that are appropriate in the light of users’ needs and cost-benefit considerations.

Paragraphs BC70–BC93 of the Basis for Conclusions describe the simplifications of recognition and measurement principles contained in full IFRSs that have been made in the proposed *IFRS for SMEs* and explain the Board’s reasoning.

Are there other recognition or 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; and

(c) how that problem might be solved.

RESPONSE

See paragraphs 53-61 of the main body of the letter.

IFAC welcomes the majority of the simplifications made though encourages further simplification of the areas mentioned in BC70-93. The following table lists these additional recognition or measurement simplifications. These include elimination of options and any other relevant points pertaining to the section.

<table>
<thead>
<tr>
<th>SECTION</th>
<th>PROBLEM AND PROPOSED SOLUTION</th>
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<tr>
<td>10 Accounting Policies, Estimates and Errors</td>
<td>We believe it will be particularly onerous for an SME to change its accounting policy in accordance with the transitional provisions of full IFRS, if an amendment is made. However, this requirement will become void if the IASB decides to eliminate all cross references to full IFRS.</td>
</tr>
<tr>
<td>11 Financial Assets and Financial Liabilities</td>
<td>We welcome the steps taken to simplify IAS 39 for SMEs in Section 11. We feel, however, that there is a case for further simplification. We suspect that the language will not prove easy for SMEs to comprehend and so suggest the IASB consider how the requirements can be clarified. In some instances the text in the basis for conclusions could be used to aid the reader’s understanding. Also, some key definitions, including derivatives, are omitted. The requirements could also be simplified with the aim of providing information to help users forecast future cash flows. We have various suggestions to support this objective as follows:</td>
</tr>
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</table>
- Eliminate the option to apply the provisions of IAS 39 instead of Section 11 (paragraph 11.1(b)).
- Clarify when financial instruments should be recognized.
- Two classes of financial assets – ‘readily realizable’ and ‘other’.
- Readily realizable financial assets and liabilities are those assets and liabilities that can be immediately traded in their existing state and without any special negotiation and for which there are observable prices. Derivatives would fall under this definition.
- Readily realizable financial assets and liabilities should be stated at fair value with changes through the profit and loss statement.
- All other financial assets liabilities should be carried at cost or amortized cost and subject to an impairment test where there is an indicative trigger.
- Amortized cost for financial assets and liabilities to be calculated using either the effective interest method or the straight-line method.
- Embedded derivatives should not be recognized.
- Simplify guidance for securitizations and factoring transactions along the lines of that used in the UK’s Financial Reporting Standard for Smaller Entities (FRSSE).

The net effect of the above would be to simplify the requirements without departing significantly from the IASB’s proposals.

13 Investments in Associates
14 Investments in Joint Ventures

Preparers often cite difficulty in obtaining the necessary information and the need to conform accounting policies and reporting dates when applying the equity and/or proportional consolidation methods. In addition, the fair value method is likely to prove unduly complex and the information less relevant to the users of SME financial statements.

Hence, we suggest SMEs should use the cost method (subject to impairment) to account for associates and joint ventures. This entails elimination of the option to use the equity method for associates (13.5) and both the equity and proportional consolidation methods for joint ventures (paragraphs 14.10 and 14.11), in so doing removing the cross-reference to IASs 28 and 31 in Sections 13 and 14. We also suggest permitting SMEs to disclose fair value information and for this purpose the cross references to the text in Section 11 should remain.

The text needs to make it clear that these provisions apply to the consolidated accounts while references to associates in Section 9 relate to accounting in the separate financial statements. Packaging all relevant material into one section on group accounting as we suggest in the main text of this letter may suitably address this.

If the IASB prefers to retain the option to use the fair value model
for associates and/or joint ventures then we suggest a simplified version of the model in full IFRS be included in the text of the IFRS for SMEs.

| 16 Property, Plant and Equipment | IFAC suspects that the components approach, that is allocating the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and depreciating separately each such part, will often prove too burdensome for SMEs. Hence, we propose that a SME depreciate all items of property, plant and equipment that are used in conjunction with one another for uniform use and purpose together as though they were a single item.

IFAC believes that the cost model (subject to impairment) will prove the most cost-beneficial for SMEs and so wonder whether the IASB should eliminate altogether the option to use the revaluation method to account for property, plant and equipment (paragraph 16.13). In most cases the revaluation model will be disproportionately costly to apply and the resulting information less relevant to SME financial statement users as compared with those of publicly accountable entities. We suggest, however, that SMEs wishing to disclose the fair values of certain assets may do so where such amounts can be reliably measured. If the IASB prefers to retain the option to use the revaluation model then we suggest a simplified version of the revaluation model in full IFRS be included in the text of the IFRS for SMEs.

While this section shares the same definition of Property, Plant and Equipment as IAS 16 it does not include any scope paragraph or scope exemptions. Accordingly, we suggest Section 16 includes the scope exemptions (a), (b) and (d) from IAS 16.

Paragraph 16.5 states that land and buildings are separable assets and an entity shall account for them separately, even when they are acquired together. Like IAS 16 Section 16 should make it clear that normally land has unlimited useful life and therefore need not be depreciated.

Finally, we suggest that the updating of residual values and useful life at least annually will prove unduly onerous (paragraph 16.17). Perhaps this review could be eliminated or else be made conditional on an indicative trigger similar to that for impairment. |

| 17 Intangible Assets other than Goodwill | We believe that SMEs should not have to distinguish between intangible assets with finite or indefinite useful life. This means that as a general rule all intangible assets, including purchased goodwill, should be treated as though assets and accordingly capitalized and amortized. As well as reducing the need for an impairment test, since the book value of the assets would diminish over time, preparers would also be freed of the burden of having to demonstrate whether an asset has a finite or indefinite useful life.

However, for development costs incurred after commercial viability has been determined, we agree with giving SMEs the option to |
either expense or capitalize. We believe users do not need such assets to be capitalized in order to assess the entity’s ability to pay its short- and medium-term liabilities. Furthermore, the expense option eases the burden for the preparers as they will not have to demonstrate whether the recognition criteria have been met or not.

While we agree with giving SMEs the option to expense or capitalize for development costs we suggest eliminating the cross reference to the full IFRS (paragraphs 17.14-17.16) and replacing it with a simplified version of the corresponding provisions in the full IFRS within the body of the SME standard. We suggest this simplification extends to eliminating the accounting policy option of using a cost or revaluation model for capitalized costs (paragraphs 17.21-17.23).

Some may argue that an expense only approach is deficient since information regarding an SME’s intangible assets may be vital to understanding its future prospects. We contend that there is nothing to stop an SME voluntarily disclosing the relevant information. In any case the aggregate amount of research and development costs recognized as an expense during the period would have to be disclosed per paragraph 17.35.

We believe that the revaluation model should be removed since it is rarely employed by listed entities let alone SMEs. This will remove the cross-reference to IAS 38. We suggest, however, that SMEs wishing to disclose the current market value of certain assets may do so where such amounts can be reliably measured.

Finally, we suggest the SME standard stress that internally generated goodwill shall not be recognized as an asset.

**19 Leases**

We welcome the measures taken to simplify the treatment of finance leases. Nevertheless, we have some suggestions on how to simplify and clarify the guidance further.

First, we suggest that the only measurement principles for assets and liabilities in a finance lease should be at an amount equal to the present value of the minimum lease payments and not fair value. We believe this value is sufficient to fairly present the value of the assets and the future liability. On the assets side the requirement to apply an impairment test (if there is an indicative trigger) should eliminate the risk of overstatement of the assets.

Second, the cross-reference in paragraph to IAS 17 in respect of accounting for finance leases in the financial statements of the lessor should be eliminated and in its place simplified provisions from full IFRS included in the text of the SME standard.

Third, paragraph 19.11 should refer to Section 17 as well as Section 16, in case the finance lease covers an intangible asset. Finally, the measurement principles should refer to Section 26 for determination of whether the leased asset has become impaired.
| 21 Equity | We note that this section is fundamentally the same as IAS 32. While provisions relating to equity should be broadly the same across all size of entity we feel that this section has inherited the lack of clarity from IAS 32. These can’t be solely resolved through revision of this ED and so do not seek to offer a solution in this letter. However, we do suggest that ‘equity shares’ be defined and that the section include a reference to financial liabilities so as to avoid misunderstanding as to the meaning of equity. The proposed approach for distinguishing between equity and liabilities presents a particular problem for certain types of legal entity such as partnerships and co-operative societies, a common legal form for SMEs in some jurisdictions, especially continental Europe. The definition of financial liabilities may lead to either ambiguous or even no distinction being made between equity and liability by such entities. In many cases these entities would present no equity capital on their balance sheet and distributions to their owners would be shown as expenses in the income statement. Ultimately, the proposed requirements for the determination of equity may result in a reluctance to apply the IFRS for SMEs. Perhaps a differential approach should be adopted with separate requirements for limited liability entities and others. |
| 26 Impairment of Non-financial Assets | IFAC welcomes the measures taken to simplify the requirements pertaining to impairment, in particular only requiring an impairment test when there is evidence to suggest an asset may have suffered impairment (indicative trigger). However, we still consider the rules to be unnecessarily complex and costly to apply in relation to the value of the information obtained. We, therefore, have a number of suggestions. First, we believe that the likelihood of an impairment test being needed, as a result of the indicative trigger being tripped, should be reduced for intangibles with indefinite life and goodwill. Impairment tests are especially burdensome for SMEs and entail considerable exercise of judgment. Hence, we propose a combination of amortization and impairment testing. Amortization will reduce the likelihood of an impairment test having to be performed as the carrying amount of the asset will diminish over time. Amortization can be justified on the basis that purchased goodwill is eventually replaced over time with internally generated goodwill that is not separately recognized. A rebuttable presumption of an economic life of, for example, 20 years could be used for goodwill. We have three further suggestions for making impairment tests in general easier for SMEs. First, we suggest the recoverable amount of an asset or a cash-generating unit be equal to either its fair value less costs to sell or its value in use as the recoverable amount. This leaves the SMEs a choice depending on whether the entity intends to keep and use the asset or intends to sell the asset. A SME would only be required to |
determine the fair value less costs to sell of the asset where a subsequent disposal of the asset is expected in the near future. This requirement could also be made conditional on it being ‘readily determinable without undue cost or effort’.

Second, we believe that the impairment should be determined based on a group of assets rather than a cash-generating unit to which the asset belongs. We do not believe in starting the impairment test on the basis of single assets. This could lead to the effect that a single asset would be impaired if its fair value less cost to sell is less than its carrying amount even if the group of assets need not be impaired. Alternatively, a cash-generating unit could be defined according to the business segments used for management purposes, that is in accordance with those business segments already used for internal reporting and control purposes. When no business segments exist, the legal entity should be assumed as the cash-generating unit.

Third and finally, we have two observations regarding the two-step process to determine whether to recognize an impairment loss for goodwill (paragraph 26.22). First, while agreeing with Step 1 we wonder how the fair value of a component could be measured. Second, we disagree with Step 2. This step is very difficult and could be avoided. After evaluating the impairment loss in Step 1 there should follow a full write down of the book value of acquired goodwill and a further allocation of impairment losses to non-cash assets and liabilities on a reasonable basis if necessary.

27 Employee Benefits

We note that increasingly defined-benefit schemes are being closed to new members and tend to be peculiar to certain jurisdictions. However, they can give rise to significant liabilities and those that have closed to new members will take many years to wind down. Hence, we suggest keeping this topic but making a clarification. While we agree that SMEs should immediately recognize all actuarial gains and losses, and so not have to apply the corridor approach, we are concerned that paragraph 27.19 is effectively asking for immediate recognition of all (vested and unvested) past service costs. Hence, we suggest that the wording around the term ‘defined benefit liability’ in paragraph 27.19 be clarified so as to exclude unvested past service costs. We believe unvested past service costs should be recognized as an expense on a straight-line basis over the average period until the benefits become vested.

28 Income Taxes

While IFAC recognizes the efforts made to simplify deferred tax for SMEs by advocating a ‘timing differences plus’ approach, we are not convinced this will lead to any meaningful simplification for SMEs. In spite of moving to a temporary approach the calculations are still complex and the result somewhat theoretical. Our own research reveals that many users are unable to appreciate the significance of the resulting information and as a result the costs of compliance exceed the benefits. This is especially so for the smaller entities. We propose, therefore, that SMEs be exempted from the
| **29 Financial Reporting in Hyperinflationary Economies** | The requirements relating to financial reporting in hyperinflationary economies should get integrated into the SME standard. The prerequisites of IAS 29 are country-specific and therefore are just as relevant to SMEs as they are to publicly accountable entities. In order to arrive at a self-contained standard the requirements should be integrated in the form of a condensed version from IAS 29. |
APPENDIX 3: QUESTION 3 – RECOGNITION AND MEASUREMENT SIMPLIFICATIONS THAT THE BOARD CONSIDERED BUT DID NOT ADOPT

Paragraphs BC94–BC107 identify some recognition and measurement simplifications that the Board considered but decided not to adopt, for the reasons noted.

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

RESPONSE

See paragraphs 53-61 of the main body of the letter.

IFAC recognizes that most of the simplifications that the Board rejected relate to recognition of liabilities. In the interests of ensuring liabilities are not understated IFAC generally concurs with the Board’s justification for not simplifying. However, IFAC does see scope for some simplification to ensure easier application of the standard. The following list includes recognition or measurement simplifications that IFAC feels the Board should reconsider. Any other relevant points pertaining to the section are also included.

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<tr>
<th>SECTION</th>
<th>PROBLEM AND PROPOSED SOLUTION</th>
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<tr>
<td>9 Consolidated and Separate Financial Statements</td>
<td>We agree with the IASB in requiring the consolidation of subsidiaries and agree with most of the proposed provisions. We do, however, have some suggestions on improving the guidance. First, on cost-benefit grounds we suggest that a subsidiary be excluded from consolidation when it is certain that control will only be temporary because the subsidiary was acquired exclusively with a view to its disposal in the near future. This will be the case when the subsidiary has either already been sold, or, as a minimum, the relevant sales contracts have been concluded prior to authorization of the financial statements. Second, a definition of the cost method should be provided either in the Glossary and/or Section 9 to make it clear how to account for income from an investment in a subsidiary when applying the cost model in the separate financial statements. Fourth, we suggest simplifying the method for allocating the cost of a business combination, in a way that allocation to contingent liabilities should not be required. Fifth, we suggest that when preparing separate financial statements the parent should account for all subsidiaries, associates and jointly controlled entities at cost. While we consider the fair value method to be unduly complex and the information less relevant to the users of SME financial statements, we suggest that the text specify that SMEs may disclose fair value information where the amounts can be measured reliably SMEs. Finally, we suggest consideration be given to including some guidance for situations where the financial statements for a subsidiary are prepared for a reporting date that differs from the...</td>
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parent. The guidance could be a suitably simplified version of the key aspects of IAS 27, for example: adjustments for the effects of significant transactions or events that occur between that date and the date of the parent financial statements; the difference between the reporting dates not be more than 3 months; and the reporting dates should be consistent from period to period.

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<tr>
<th>Section</th>
<th>Recommendation</th>
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<tr>
<td>20 Provisions and Contingencies</td>
<td>We broadly support the decision to import much of IAS 37 into this section. However, we still feel that some simplification is needed. In particular, the present value calculations should be more straightforward so as to ease the burden of SMEs operating in less developed capital markets where there is limited availability of market data. We propose using the entity’s average borrowing rate as the discount rate.</td>
</tr>
<tr>
<td>22 Revenue</td>
<td>We agree with the proposal to require the use of percentage of completion method but to ensure consistent application we suggest including guidance on the elements of contract revenue and contract cost. We also suggest that the scope paragraph refer to revenue arising from construction contracts.</td>
</tr>
<tr>
<td>36 Discontinued Operations and Assets Held for Sale</td>
<td>This section contains in principle the majority of the provisions of IFRS 5. We believe many of these provisions are too complex for SMEs on cost-benefit grounds. Accordingly, we have various suggestions. In particular, the concept of assets held for sale should be deleted completely (including disposal groups). This concept gives minimal additional information and as such does not justify an autonomous measurement model. We believe that with regard to discontinued operations it is sufficient to disclose the effect on profit or loss. Finally, since re-statement of information is burdensome especially for SMEs we suggest limiting the requirement to identify information for the year in which the decision to sell or discontinue is made. Restated information for prior years should be encouraged but not required.</td>
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</table>
APPENDIX 4: QUESTION 4 – WHETHER ALL ACCOUNTING POLICY OPTIONS IN FULL IFRSs SHOULD BE AVAILABLE TO SMEs

The draft IFRS for SMEs proposes that accounting policy options available under full IFRSs should generally also be available to SMEs. As explained more fully in paragraphs BC108–BC115 of the Basis for Conclusions, the Board concluded that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities following full IFRSs. At the same time, the Board recognized that most SMEs are likely to prefer the simpler option in the proposed IFRS for SMEs. Therefore, the Board concluded that in six circumstances in which full IFRSs allow accounting policy options, the IFRS for SMEs should include only the simpler option, and the other (more complex) option(s) should be available to SMEs by cross-reference to the full IFRSs.

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?

Shoule 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?

RESPONSE

See paragraphs 22-24 and 47-52 of the main body of the letter.

We do not believe that there are additional options that should be made available in the IFRS for SMEs. We believe, however, that all of the options offered by way of cross-reference to full IFRSs should be either eliminated altogether or else the text relating to the option included within the SME standard itself. Outright elimination is recommended for topics which we consider relate to a small minority of SMEs and/or options relating to the use of fair values in place of cost. For all other topics we suggest inclusion of the option within the standard itself by replacing the cross-references with a simplified version of the corresponding provisions in the full IFRS within the main body of the SME standard.

Most cases of cross references have been covered above in Appendices 1-3. The table below provides a summary of any other options to be eliminated together with any specific reasons for their elimination in addition to the generic reasons given in the main body of the letter. Any other relevant points pertaining to the section are also included.

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<th>SECTION</th>
<th>RATIONALE FOR ELIMINATION</th>
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<tr>
<td>7 Cash Flow Statement</td>
<td>Evidence, including our own research, indicates that creditors are a key source of finance for SMEs and this vindicates the decision to require that a SME produce a cash flow statement. We believe the direct method option for the cash flow statement should be removed. Evidence suggests few listed entities use it and users do not consider it useful.</td>
</tr>
<tr>
<td>15 Investment Property</td>
<td>IFAC believes that the cost model (subject to impairment) will prove the most cost-beneficial for SMEs and so wonder whether the IASB should eliminate altogether the option to</td>
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</table>
use the fair value model to account for investment property
and that the option to use the fair value model be eliminated
(paragraph 15.5). The cross reference to IAS 40 will
automatically disappear as a result. We suggest, however, that
the text state that SMEs wishing to disclose the fair value of
certain assets may do so where such amounts can be reliably
measured. If the IASB prefers to retain the option to use the
fair value model then we suggest a simplified version of the
model in full IFRS be included in the text of the IFRS for
SMEs.

We also believe in eliminating the option to account for a
property interest that is held by a lessee under an operating
lease as an investment property in Sections 15 and 19. This
option adds unnecessary complexity.

| 23 Government Grants | We are pleased to see a simplified SME model in the ED. We
suggest eliminating the cross-referenced option to full IFRS in
paragraph 23.3(b). |
APPENDIX 5: QUESTION 5 – BORROWING COSTS

IAS 23 Borrowing Costs currently allows entities to choose either the expense model or the capitalization model to account for all of their borrowing costs. In May 2006 the IASB published an Exposure Draft proposing to amend IAS 23 to prohibit the expense model and to require the capitalization model. Section 24 Borrowing Costs of the draft IFRS for SMEs proposes to allow SMEs to choose either the expense model or the capitalization model.

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

RESPONSE

We agree with the proposal to allow SMEs to choose either the expense model or the capitalization model for borrowing costs. There is no clearly superior approach in terms of cost-benefit and user needs. Furthermore, the appropriate approach may well depend on the size of the SME with expensing most suited to smaller SMEs and capitalization to larger SMEs that have the appropriate information systems in place.

While we believe in giving SMEs the freedom to choose, as the ED proposes, we suggest eliminating the cross-reference to IAS 23 (paragraph 24.4) and replacing the cross-reference with a simplified version of the corresponding provisions in the full IFRS within the body of the SME standard. For example, we suggest that capitalization of borrowing costs be computed on the basis of the average borrowings of the entity.
APPENDIX 6: QUESTION 6 – TOPICS NOT ADDRESSED IN THE PROPOSED IFRS FOR SMEs

Some topics addressed in full IFRSs are omitted from the draft IFRS for SMEs because the Board believes that typical SMEs are not likely to encounter such transactions or conditions. These are discussed in paragraphs BC57–BC65 of the Basis for Conclusions. By a cross-reference, the draft standard requires SMEs that have such transactions to follow the relevant full IFRS.

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

RESPONSE

See paragraphs 22-24 and 47-52 of the main body of the letter and appendices above.
APPENDIX 7: QUESTION 7 – GENERAL REFERRAL BACK TO FULL IFRSs

As noted in Question 1, the IFRS for SMEs is intended to be a stand-alone document for typical SMEs. It contains cross-references to particular full IFRSs in specific circumstances, including the accounting policy options referred to in Question 4 and the omitted topics referred to in Question 6. For other transactions, events or conditions not specifically addressed in the IFRS for SMEs, paragraphs 10.2–10.4 propose requirements for how the management of SMEs should decide on the appropriate accounting. Under those paragraphs, it is not mandatory for SMEs to look to full IFRSs for guidance.

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?

RESPONSE

See paragraphs 22-24 and 47-52 of the main body of the letter.
APPENDIX 8: QUESTION 8 – ADEQUACY OF GUIDANCE

The draft *IFRS for SMEs* is accompanied by some implementation guidance, most notably a complete set of illustrative financial statements and a disclosure checklist. A sizeable amount of guidance that is in full IFRSs is not included. Accordingly, additional guidance especially tailored to the needs of SMEs applying the proposed IFRS may be required.

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

RESPONSE

See paragraphs 67-69 of the main body of the letter.
Appendix 9: Question 9 – Adequacy of disclosure

Each section of the draft *IFRS for SMEs* includes disclosure requirements. Those requirements are summarized in the disclosure checklist that is part of the draft implementation guidance *Illustrative Financial Statements and Disclosure Checklist*.

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?

Response

See paragraph 70 of the main body of the letter.

IFAC is pleased to see a significant reduction in the disclosures as compared with full IFRS. This should greatly reduce the volume of SME financial statements and ensure users focus on what’s most relevant. However, we believe that users of SME financial statements need limited supplementary information. Creditors and employees wish to assess the ability of the entity to meet its obligations and to sustain its operations. Meanwhile, non-controlling owners wish, in addition to do the same while also assess whether their interests in the entity are safeguarded. In other words users of SME financial statements seek a succinct and simple set of disclosures which helps them understand the financial position of the entity as well as changes in this position during the past year. This suggests even further reductions from those proposed.

While many of the changes proposed in Appendices 1-8 above will remove some disclosures we feel there is scope for further reductions by focusing on the following:
<table>
<thead>
<tr>
<th>DISCLOSURE ITEM</th>
</tr>
</thead>
<tbody>
<tr>
<td>A summary of significant accounting policies used in preparing the financial statements</td>
</tr>
<tr>
<td>Explanation and effect of all changes in accounting policies and of prior period errors on opening balance of equity for the current period</td>
</tr>
<tr>
<td>Description, including maturity by specific intervals and interest rates, of all material financial debt including finance lease arrangements</td>
</tr>
<tr>
<td>Details of hedging strategies and related carrying amounts in the balance sheet</td>
</tr>
<tr>
<td>Description, including total minimum lease payments at the end of specific intervals, of all material operating lease arrangements</td>
</tr>
<tr>
<td>Analysis into amounts at cost and fair value of each category of asset and liability</td>
</tr>
<tr>
<td>Reconciliation between opening and closing balances for each class of non-current asset</td>
</tr>
<tr>
<td>Reconciliation between opening and closing balances for each class of non-current liability and provision</td>
</tr>
<tr>
<td>Summarized information for each subsidiary</td>
</tr>
<tr>
<td>Summarized information for each interest in associates and/or joint ventures, including aggregated amounts of assets, liabilities, revenues, profit or loss, percentage of ownership, and nature of any significant restrictions.</td>
</tr>
<tr>
<td>Details of all significant transactions and events, including disposals, acquisitions, impairments, and business combinations, for the current period</td>
</tr>
<tr>
<td>Details of off balance sheet items</td>
</tr>
<tr>
<td>Details of contingent liabilities and assets</td>
</tr>
<tr>
<td>Basic and effective income tax rates</td>
</tr>
</tbody>
</table>
APPENDIX 10: QUESTION 10 – TRANSITION GUIDANCE

Section 38 *Transition to the IFRS for SMEs* provides transition guidance for SMEs that move (a) from national GAAP to the *IFRS for SMEs* and (b) from full IFRSs to the *IFRS for SMEs*.

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

**RESPONSE**

See paragraphs 71-72 of the main body of the letter.
APPENDIX 11: QUESTION 11 – MAINTENANCE OF THE IFRS FOR SMEs
RESPONSE
See paragraphs 73-75 of the main body of the letter.