Request for Information
Comprehensive Review of the IFRS for SMEs

response to request

3 December 2012

the people
in public finance

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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
Submitted electronically to www.ifrs.org
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Dear IASB secretariat

Request for Information *Comprehensive Review of the IFRS for SMEs*

CIPFA is pleased to present its comments on the matters discussed in this Request for Information, which have been reviewed by CIPFA's Accounting and Auditing Standards Panel.

General comments on not-for-profit issues

While CIPFA has an interest in financial reporting generally, we have a specific interest in both public sector and wider not-for-profit reporting. We therefore have a particular interest in questions relating to extending the use of IASB standards to not-for-profit entities.

In responding to successive IASB consultations and exposure drafts, CIPFA has commented both on generic aspects of standards development, and issues relating to the application of standards to the public sector and the wider not-for-profit or public benefit sector. This includes cases where CIPFA has disagreed with the detail or the direction of IASB development because of potential consequences when applied to public sector or not-for-profit sector reporting. Where the Board has taken a line which CIPFA would not support this has sometimes been explicitly justified in terms of an increasing focus on the needs of investors and analysts, while in other cases the situation is less clear.

In CIPFA's response to the 2011 Agenda consultation, we suggested that the Board consider moving Phase G of the Conceptual Framework back on to its active agenda. We appreciate that standards have been developed with a for-profit focus for the reasons explained by the Board. However, we consider that many of these standards can be easily repurposed for use in the non-profit sector, provided that there is a clear statement of how standard setting in the not-for-profit sector should differently reflect the differing characteristics of the sector, while maintaining consistency of presentation in those areas where this is beneficial.

However, while the Board has restarted work on the Conceptual Framework, it is not currently pursuing Phase G given its current focus on business entities.

We would note that a standard based on the IASB *IFRS for SMEs* is in the final stages of development by the UK Financial Reporting Council, and that this does include guidance for 'public benefit' entities. CIPFA has supported this development. The development process has moved toward a standard which is less closely aligned with the *IFRS for SMEs* than was originally proposed by the FRC, but on the whole we consider that these developments demonstrate that the *IFRS for SMEs* can be adapted to encompass reporting on not-for-profit entities.

The UK development has been carried out in the context of a longstanding programme whereby UK GAAP has been mainly articulated in terms of for-profit entities, and has also been interpreted for use by public benefit entities. This interpretation process has been carried out in the light of conceptual material set out in a *Statement of Principles for Financial Reporting* developed by the Accounting Standards Board, together with an *Interpretation for Public Benefit Entities* developed by the Committee on Accounting for Public Benefit Entities (CAPE).

Both the current round of standards development, and earlier interpretation of UK GAAP for specific sub-sectors of not-for-profit entities were subject to consultation exercises which engaged with key stakeholders in public benefit financial reporting.

It is against this background that we have considered the *Comprehensive Review of the IFRS for SMEs* and the specific question of whether the *IFRS for SMEs* might be used as a basis for reporting by not-for-profit entities.

In our view we consider that it would be helpful for an international standards provider to produce a standard which could be applied to not-for-profit entities, thereby filling a substantial gap. Neither full *IFRS* nor *IFRS for SMEs* provide an adequate and comprehensive basis for not-for-profit reporting in their current form. In line with our earlier comments, we consider that this could be achieved by adapting existing standards. Key requirements of such an adaptation or augmentation process would be

- A clear conceptual underpinning which set out the basis for modifying or disapplying the reporting developed for 'for profit' entities; and

- A consultation process which takes due account of the concerns of stakeholders in not-for-profit reporting insofar as they are relevant to that reporting.

In the context of the economic crisis and continuing difficulties we fully understand that there will be pressures on the IASB to be primarily driven by the concerns of listed companies, so the Board may wish to carry out any conceptual work as a smaller project rather than as part of the overall Conceptual Framework. The Board might wish to make use of material such as that developed by CAPE in the UK. We would also note that CAPE has had regard to the work of IPSASB on matters such as Revenue from Non-Exchange Transactions which span both private and public sector not-for-profit.

Other comments

We also attach comments on *Part A: Specific questions on Sections 1-35 of the IFRS for SMEs* and Part *B: General questions*. These comments mainly address the not-for-profit issue.

I hope this helps the Board in its development of standards guidance.

Yours faithfully

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Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

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Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S1 **Use by publicly traded entities (Section 1)**
Are the scope requirements of the *IFRS for SMEs* currently too restrictive for publicly traded entities? (a) No—do not change the current requirements. Continue to prohibit an entity whose debt or equity instruments trade in a public market from using the *IFRS for SMEs*. (b) Yes—revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether entities whose debt or equity instruments are traded in a public market should be permitted or required to use the *IFRS for SMEs*. (c) Other—please explain.
CIPFA does not have strong views on this matter. On balance we would tend toward (a) in the interests of clarity, although we are not totally opposed to (b). We can see that there may be some jurisdictions where most or all of the entities whose debt or equity instruments are traded in a public market are very small. In these jurisdictions, local regulators might consider the lesser requirements of the *IFRS for SMEs* to provide sufficient information for accountability purposes. Currently they can implement comparable requirements by developing local standards based on *IFRS for SMEs*, but cannot apply *IFRS for SMEs* directly. Obviously it is important that the use of simpler standards by publicly traded entities is not taken to incorrectly imply that they are not publicly traded entities.

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S2 **Use by financial institutions (Section 1)**
Are the scope requirements of the *IFRS for SMEs* currently too restrictive for financial institutions and similar entities? (a) No—do not change the current requirements. Continue to prohibit all financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses from using the *IFRS for SMEs*. (b) Yes—revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether any financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses should be permitted or required to use the *IFRS for SMEs*. (c) Other—please explain.
On balance (b) may be helpful. We can see that some jurisdictions might have some financial institutions (FIs) and entities holding assets in a fiduciary capacity (EHAIAFCs) which are very small, and that local regulators might consider the lesser requirements of the *IFRS for SMEs* to provide sufficient information for accountability purposes. Currently they can implement such requirements by developing local standards based on *IFRS for SMEs*. Obviously it is important that the use of simpler standards by FIs/EHAIAFCs is not taken to incorrectly imply that they are not FIs/EHAIAFCs. Whether using local standards or *IFRS for SMEs*, we suggest that financial reporting should make it clear that the reporting entity is one which falls within the definition of public accountability, but where the regulator has deemed in a particular context the reduced reporting provides adequate information for accountability purposes.

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S3 **Clarification of use by not-for-profit entities (Section 1)**

Should the *IFRS for SMEs* be revised to clarify whether an NFP entity is eligible to use it?

(a) Yes—clarify that soliciting and accepting contributions does not automatically make an NFP entity publicly accountable. An NFP entity can use the *IFRS for SMEs* if it otherwise qualifies under Section 1.

(b) Yes—clarify that soliciting and accepting contributions will automatically make an NFP entity publicly accountable. As a consequence, an NFP entity cannot use the *IFRS for SMEs*.

(c) No—do not revise the *IFRS for SMEs* for this issue.

(d) Other—please explain.

d) Other

Recent developments in IFRSs have focussed on the reporting needs of stakeholders of investors in for-profit entities. Some of this development, including the redefining the users of general purpose financial reporting, and the refocusing of fair value on market exit values, might be seen as reducing the relevance of IFRS reporting to stakeholders in financial reporting by not-for-profit entities such as charities.

The *IFRS for SMEs* has been developed by reference to IFRS with a view to reducing complexity and onerous requirements. However, none of the development appears to have explicitly focussed on the reporting needs of not-for-profits.

In the United Kingdom, charities are explicitly forbidden from using IFRS.

The UK Financial Reporting Council is developing reporting for 'public benefit entities' including charities, and proposes to do this using a local standard for SME reporting which has regard to *IFRS to SMEs*, but which

- includes additional material relating to public benefit entities; and
- differs from *IFRS for SMEs* in other ways, mainly including some treatments which are allowed under IFRSs but not under *IFRS for SMEs.*

As explained in our covering letter, it would be helpful to have authoritative guidance for private sector not-for-profit entities. *IFRS for SMEs* would be a helpful starting point, but significant additions and interpretation would also be required.

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S4 **Consideration of recent changes to the consolidation guidance in full IFRSs (Section 9)** **Should the changes outlined [in the request for information] be considered, but modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?** (a) No—do not change the current requirements. Continue to use the current definition of control and the guidance on its application in Section 9. They are appropriate for SMEs, and SMEs have been able to implement the definition and guidance without problems. (b) Yes—revise the *IFRS for SMEs* to reflect the main changes from IFRS 10 outlined above (modified as appropriate for SMEs). (c) Other—please explain.
The alignment of the IFRS for SMEs with IFRS envisaged in option b) is desirable. If the *IFRS for SMEs* were used as a basis for financial reporting by not-for profit entities, then we would expect some additional guidance on the identification of control to be necessary.
S5 **Use of recognition and measurement provisions in full IFRSs for financial instruments (Section 11)** **How should the current option to use IAS 39 in the *IFRS for SMEs* be updated once IFRS 9 has become effective?** (a) There should be no option to use the recognition and measurement provisions in either IAS 39 or IFRS 9. All SMEs must follow the financial instrument requirements in Sections 11 and 12 in full. (b) Allow entities the option of following the recognition and measurement provisions of IFRS 9 (with the disclosure requirements of Sections 11 and 12). (c) Other—please explain.
CIPFA supports option (b).

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S6 **Guidance on fair value measurement for financial and non-financial items (Section 11 and other sections)** **Should the fair value guidance in Section 11 be expanded to reflect the principles in IFRS 13, modified as appropriate to reflect the needs of users of SME financial statements and the specific circumstances of SMEs (for example, it would take into account their often more limited access to markets, valuation expertise, and other cost-benefit considerations)?** (a) No—do not change the current requirements. The guidance for fair value measurement in paragraphs 11.27–11.32 is sufficient for financial and non-financial items. (b) Yes—the guidance for fair value measurement in Section 11 is not sufficient. Revise the *IFRS for SMEs* to incorporate those aspects of the fair value guidance in IFRS 13 that are important for SMEs, modified as appropriate for SMEs (including the appropriate disclosures). (c) Other—please explain.
As noted in our covering letter and the answer to S3, if *IFRS for SMEs* is used as a basis for not-for-profit entities, it would be necessary to extend the basis for measurement to properly encompass the service potential of assets which are not used with a view to achieving a profit.
S7 **Positioning of fair value guidance in the Standard (Section 11)** **Should the guidance be moved into a separate section? The benefit would be to make clear that the guidance is applicable to all references to fair value in the *IFRS for SMEs*, not just to financial instruments.** (a) No—do not move the guidance. It is sufficient to have the fair value measurement guidance in Section 11. (b) Yes—move the guidance from Section 11 into a separate section on fair value measurement. (c) Other—please explain.
CIPFA has no strong views on this matter.

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S8 **Consideration of recent changes to accounting for joint ventures in full IFRSs (Section 15)**

Should the changes above to joint venture accounting in full IFRSs be reflected in the *IFRS for SMEs*, modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

(a) No—do not change the current requirements. Continue to classify arrangements as jointly controlled assets, jointly controlled operations and jointly controlled entities (this terminology and classification is based on IAS 31 *Interests in Joint Ventures*). The existing Section 15 is appropriate for SMEs, and SMEs have been able to implement it without problems.

(b) Yes—revise the *IFRS for SMEs* so that arrangements are classified as joint ventures or joint operations on the basis of the parties' rights and obligations under the arrangement (terminology and classification based on IFRS 11 *Joint Arrangements*, modified as appropriate for SMEs).

(c) Other—please explain.

CIPFA has no comment on this insofar as it applies to for-profit entities.

If standards or guidance for Not-For-Profit entities were to be based on *IFRS for SMEs* then additional care would be needed to develop an approach based on current IFRS, because of the rather different way in which assets are held and control is exercised in the not-for- profit sector.

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

Should an option to use the revaluation model for PPE be added to the *IFRS for SMEs*?

(a) No—do not change the current requirements. Continue to require the cost-depreciation-impairment model with no option to revalue items of PPE.

(b) Yes—revise the *IFRS for SMEs* to permit an entity to choose, for each major class of PPE, whether to apply the cost-depreciation-impairment model or the revaluation model (the approach in IAS 16).

(c) Other—please explain.

Please provide reasoning to support your choice of (a), (b) or (c).

CIPFA supports option (b) particularly insofar as the *IFRS for SMEs* may become a basis for Not-For-Profit entities.

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S10 **Capitalisation of development costs (Section 18)**

Should the *IFRS for SMEs* be changed to require capitalisation of development costs meeting criteria for capitalisation (on the basis of on the criteria in IAS 38)?

(a) No—do not change the current requirements. Continue to charge all development costs to expense.

(b) Yes—revise the *IFRS for SMEs* to require capitalisation of development costs meeting the criteria for capitalisation (the approach in IAS 38).

(c) Other—please explain.

Please provide reasoning to support your choice of (a), (b) or (c).

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

Should paragraph 18.20 be modified to state: "If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years unless a shorter period can be justified"?

(a) No—do not change the current requirements. Retain the presumption of ten years if an entity is unable to make a reliable estimate of the useful life of an intangible asset (including goodwill).

(b) Yes—modify paragraph 18.20 to establish a presumption of ten years that can be overridden if a shorter period can be justified.

(c) Other—please explain.

CIPFA has no comment on these questions insofar as they apply to for-profit entities.

If standards or guidance for Not-For-Profit entities were to be based on *IFRS for SMEs* then consideration would be need to be given to the question of whether an approach based on current IFRS would be more appropriate.

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S12 **Consideration of changes to accounting for business combinations in full IFRSs (Section 19)** **Should Section 19 be amended to incorporate the changes [in the request for information], modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?** (a) No—do not change the current requirements. The current approach in Section 19 (based on IFRS 3 (2004)) is suitable for SMEs, and SMEs have been able to implement it without problems. (b) Yes—revise the *IFRS for SMEs* to incorporate the main changes introduced by IFRS 3 (2008), as outlined above and modified as appropriate for SMEs. (c) Other—please explain.
CIPFA would support option (c) if the *IFRS for SMEs* were to become a basis for Not-For-Profit entities. The use of the acquisition accounting method may not give a faithful representation of entity combinations in all NFP combinations. Many combinations in the charity sector occur between entities which already share common objectives and interests, and the resulting combination may in many cases be considered to properly reflect a pooling of interests rather than an asymmetric assumption of control of an acquired entity by an acquiring entity.
S13 **Presentation of share subscriptions receivable (Section 22)** **Should paragraph 22.7(a) be amended either to permit or require the presentation of the receivable as an asset?**
CIPFA has no strong views on this matter.

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S14 **Capitalisation of borrowing costs on qualifying assets (Section 25)** **Should Section 25 of the *IFRS for SMEs* be changed so that SMEs are required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, with all other borrowing costs recognised as an expense when incurred?** (a) No—do not change the current requirements. Continue to require all borrowing costs to be recognised as an expense when incurred. (b) Yes—revise the *IFRS for SMEs* to require capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (the approach in IAS 23). (c) Other—please explain.
On balance CIPFA supports option (a).
S15 **Presentation of actuarial gains or losses (Section 28)** **Should the option to recognise actuarial gains and losses in profit or loss be removed from paragraph 28.24?** (a) No—do not change the current requirements. Continue to allow an entity to recognise actuarial gains and losses either in profit or loss or in other comprehensive income as an accounting policy election. (b) Yes—revise the *IFRS for SMEs* so that an entity is required to recognise all actuarial gains and losses in other comprehensive income (ie removal of profit or loss option in paragraph 28.24). (c) Other—please explain.
CIPFA supports option (b).

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S16 **Approach for accounting for deferred income taxes (Section 29)** **Should SMEs recognise deferred income taxes and, if so, how should they be recognised?**
S17 **Consideration of IAS 12 exemptions from recognising deferred taxes and other differences under IAS 12 (Section 29)** **Should Section 29 be revised to conform it to IAS 12, modified as appropriate to reflect the needs of the users of SME financial statements?**
S18 **Rebuttable presumption that investment property at fair value is recovered through sale (Section 29)** **Should Section 29 be revised to incorporate a similar exemption from paragraph 29.20 for investment property at fair value?**
CIPFA has no comments to make on matters S16 to S18
S19 **Inclusion of additional topics in the *IFRS for SMEs*** **Are there any topics that are not specifically addressed in the *IFRS for SMEs* that you think should be covered (ie where the general guidance in paragraphs 10.4–10.6 is not sufficient)?**
We have no further comments to make on the application of the *IFRS for SMEs* to for-profit entities.

Part A: Specific questions on Sections 1-35 of the *IFRS for SMEs*

S20 **Opportunity to add your own specific issues**

Are there any additional issues that you would like to bring to the IASB's attention on specific requirements in the sections of the *IFRS for SMEs*?

(a) No.

(b) Yes (please state your issues, identify the section(s) to which they relate, provide references to paragraphs in the *IFRS for SMEs* where applicable and provide separate reasoning for each issue given).

Were the *IFRS for SMEs* to be extended to not-for-profits, including charities, or otherwise used as the basis for local or international guidance for not-for-profits, it would be necessary to address certain issues which are either specific to the sector, or where there are significant differences in operation or in the factors which make information relevant to the readers of those entities' financial reporting.

We strongly recommend that the following issues are addressed:

- The recognition of assets arising from non-exchange transactions.
- Recognition and measurement issues relating to assets that are held for purposes other than for making a profit or for cash generation.
- Obligations that are of a non-exchange nature and whilst not enforceable under contract may still result in an unavoidable outflow of resources
- The concept of control may need further consideration, both in respect of control over assets and control of one entity over another.
- Acquisition accounting may not always reflect the substance of a combination when charities come under common control or merge to take forward a shared purpose.

In practice the financial reporting will also have to be flexible enough to provide relevant and useful information having regard to legal restrictions which may be placed upon the use of assets.

In order to address the above issues in a coherent and effective way, it would be very useful to re-open the Board's consideration of Phase G of its Conceptual Framework project – Application to Not-For-Profit Entities, or perhaps to carry out a smaller project in the context of the *IFRS for SMEs*, in order to provide a sound basis for extending and interpreting standards developed with the interests of for-profit entities and their stakeholders in mind.

G1 **Consideration of minor improvements to full IFRSs**

G2 **Further need for Q&As**

G3 **Treatment of existing Q&As**

G4 **Training material**

G5 **Opportunity to add any further general issues**

CIPFA has no comments to make on General Questions 1 to 5

G6 **Use of *IFRS for SMEs* in your jurisdiction**

This question contains four sub-questions. The purpose of the questions is to give us some information about the use of the *IFRS for SMEs* in the jurisdictions of those responding to this Request for Information.

1 What is your country/jurisdiction?

2 Is the *IFRS for SMEs* currently used in your country/jurisdiction?

(a) Yes, widely used by a majority of our SMEs.

(b) Yes, used by some but not a majority of our SMEs.

(c) No, not widely used by our SMEs.

(d) Other (please explain).

3 If the *IFRS for SMEs* is used in your country/jurisdiction, in your judgement what have been the principal benefits of the *IFRS for SMEs*?

4 If the *IFRS for SMEs* is used in your country/jurisdiction, in your judgement what have been the principal practical problems in implementing the *IFRS for SMEs*?

1. CIPFA is based in the United Kingdom (although we also have regard to public sector and public benefit reporting worldwide).
2. The *IFRS for SMEs* is not used in the United Kingdom. However, the UK Financial Reporting Council is in the process of moving to standards based on but not identical to, the *IFRS for SMEs.*
3. Not applicable.
4. Not strictly applicable. However, we would note that

- the process of developing UK standards largely based on the *IFRS for SMEs* was held back by stakeholder dissatisfaction with a proposed UK FRS which was very closely based on the *IFRS for SMEs*.
- The UK also produced guidance on the application of the standard to the public benefit sector; initially this was in a separate standard
- Progress has been made mainly by amending the proposed UK FRS to allow treatments which are allowed under both full IFRS and currently extant UK GAAP, particularly in the area of allowing the revaluation basis for non-financial assets.