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Exposure Draft ED/2013/9 Proposed amendments to the International Financial Reporting Standard for Small and Medium-sized Entities

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft ED/2013/9 *Proposed amendments to the International Financial Reporting Standard for Small and Medium-sized Entities* (the ED). We have considered the ED, as well as the accompanying draft Basis for Conclusions.

Our main comments are summarised below. Our responses to the questions in the ED's Invitation to Comment are set out in Appendix A.

General comments

Support for the specific proposals within the ED

We broadly support the proposals set out in the ED, which we consider to be uncontroversial in the main. The most significant of the proposals, as the Board itself has noted, is that relating to the taxation section of the Standard. We agree with the Board's proposal here to align the requirements of the *International Financial Reporting Standard for Small and Medium-sized Entities* (the IFRS for SMEs or the Standard) with those in IAS 12 *Income Taxes* although we note that IAS 12 is itself a complicated standard which merits review by the Board in the fullness of time. We expand on this point in our response to question 2 in the ED.

Concern over expansion of the undue cost or effort concept

The ED proposes to clarify the meaning of 'undue cost or effort' (in Section 2 *Concepts and Pervasive Principles* of the IFRS for SMEs) and also to add related exemptions in a few new areas in the updated version of the Standard. We acknowledge that this concept already exists in the IFRS for SMEs and support the objective of clarifying it.

However, we do have a concern that the clarification proposed will in practice result in a low bar for using the existing and proposed undue cost or effort exemptions – potentially to the extent of these becoming *de facto* accounting policy choices. Our main reason for saying this is that the key management personnel of SMEs are very unlikely to have a rigorous or verifiable basis for assessing how the decisions of expected users could be affected by the availability of the information in question. We also feel that the ultimate judgement on whether it is appropriate to use such an exemption would often fall on auditors.

For these reasons we urge caution in further extending the use of undue cost or effort exemptions in this and future revisions of the Standard. If the Board believes that a proposed accounting treatment will commonly involve costs that exceed the benefits it would be preferable to select a different treatment.

The need for a clearer framework for future revisions of the IFRS for SMEs

While we are generally supportive of the specific proposals made in the ED, we believe that it would be useful to take this opportunity to put in place a clearer and publicly available framework for deciding what sort of changes should be made to the IFRS for SMEs in the future. Such a framework could then be used both by the Board in formulating proposed changes to the Standard and by constituents in evaluating whether such proposed changes should be implemented.

Such a framework could for instance cover matters such as:

- costs and benefits
- circumstances in which changes to full IFRS should be reflected in the IFRS for SMEs
- the timescale for cyclical reviews of the IFRS for SMEs
- accounting policy choices.

We comment on each of these individual matters below:

Costs and benefits

We believe that the framework governing revisions to the IFRS for SMEs should clearly emphasise the need to undertake a thorough cost/benefit analysis when formulating proposed changes to the Standard.

This would reflect our belief that there is a greater need for stability in the IFRS for SMEs compared to full IFRS as entities applying the IFRS for SMEs will generally have less resources to cope with changes. We therefore believe that changes to the IFRS for SMEs should only be proposed where it can be demonstrated that a serious problem exists.

Circumstances in which changes to full IFRS should be reflected in the IFRS for SMEs

Following on from the point above, we also believe that changes to full IFRS should only be reflected in the IFRS for SMEs when those changes are equally relevant to an entity operating under the IFRS for SMEs. This reflects our view that the IFRS for SMEs should be judged on its own terms as a less complex standard and the general principle should be to try to minimise changes to it wherever possible. We also believe the IFRS for SMEs should not reflect changes in full IFRS that are not yet in mandatory effect. Again, we believe it would be useful for the Board's stance on such matters to be incorporated in a framework governing what types of revision should be made to the IFRS for SMEs.

The timescale for cyclical reviews of the IFRS for SMEs

Another issue that we believe should be included in a publicly available framework for making revisions to the IFRS for SMEs is the timescale for cyclical reviews of the Standard. We believe here that a three-year cycle for reviewing the Standard continues to be broadly appropriate given that it is intended to be less complex than full IFRS.

Where new IFRSs have been issued since the last revision, we do not believe it would be right to wait for completion of post-implementation reviews of those new IFRSs before considering the need for changes to the IFRS for SMEs however. In our view the length of time needed to complete such post-implementation reviews is too great and could therefore result in too big a gap emerging between the IFRS for SMEs and full IFRS.

Accounting policy choices

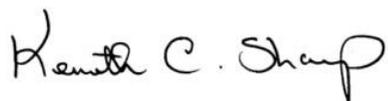
We would also like the framework for revisions to the IFRS for SMEs to clarify the Board's thinking in relation to the inclusion of accounting policy choices in the Standard.

Our own view is that accounting policy choices should be kept to a minimum in the Standard. We accept that the inclusion of additional accounting policy choices would make the Standard attractive to more developed jurisdictions, particularly those that have sophisticated capital markets. However, we feel that it is almost inevitable that such jurisdictions will need to make changes to the Standard to reflect issues which are specific to them, such as those arising from company law or tax law. We believe it would be impossible for the Board to cater for all of these jurisdictional requirements, and that it is better to have a basic standard with a minimum of choices. Individual jurisdictions can then take the IFRS for SMEs as a starting point and add to these requirements if they deem this to be necessary.

We note here that some of the more developed jurisdictions that have argued for more accounting policy choices also typically have greater resources to issue their own country-specific versions of the Standard. By way of contrast, following an alternative path of adding accounting policy choices would increase the complexity of the Standard and may dissuade some small jurisdictions (that have the most to benefit from the IFRS for SMEs) from adopting the Standard. In situations where such jurisdictions have already adopted the Standard, it could even lead them to revert to their previous local GAAP requirements. We also note that in many countries, those entities that feel the IFRS for SMEs is unduly restrictive in the area of accounting policy choices would have the possibility of moving to full IFRS as a means of mitigating this.

If you have any questions on our response, or wish us to amplify our comments, please contact our Global Head of IFRS, Andrew Watchman (andrew.watchman@gti.gt.com or telephone + 44 207 391 9510).

Yours sincerely,



Kenneth C Sharp
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Appendix A

Question 1 – Definition of ‘fiduciary capacity’

The IASB has received feedback that the meaning of ‘fiduciary capacity’ in the definition of ‘public accountability’ (see paragraph 1.3(b) of the IFRS for SMEs) is unclear as it is a term with different implications across jurisdictions. However, respondents generally did not suggest alternative ways of describing public accountability or indicate what guidance would help to clarify the meaning of ‘fiduciary capacity’. Based on the outreach activities to date, the IASB has determined that the use of this term does not appear to create significant uncertainty or diversity in practice.

(a) Are you aware of circumstances where the use of the term ‘fiduciary capacity’ has created uncertainty or diversity in practice? If so, please provide details.

(b) Does the term ‘fiduciary capacity’ need to be clarified or replaced? Why or why not? If you think it needs to be clarified or replaced, what changes do you propose and why?

We are not aware of circumstances where the use of the term 'fiduciary capacity' has created uncertainty or diversity in practice. We also believe that if the term does create problems for particular jurisdictions, then those jurisdictions are likely to counter the problems themselves by altering the scope of the Standard to reflect their own needs. As a result we do not consider it is necessary to replace the term. We instead support the limited amendments to the definition that are proposed in the ED and do not consider more widespread changes to be necessary.

In relation to the scope of the Standard more generally, we are aware that some countries have made changes to the IFRS for SMEs to reflect their own particular legal and accounting framework. We are also aware that, in some countries, a number of large complex organisations fall within the scope of the local version of the IFRS for SMEs, and that various concerns have arisen as a result of this. As noted in our general comments however we feel that it is almost inevitable that such jurisdictions will need to make changes to the Standard to reflect issues which are specific to them, and that it is better for them to use the IFRS for SMEs as a starting point in developing their own Standard rather than increase the complexity of the Standard for others. We do not see the need then for widespread changes in this area.

Question 2 - Accounting for income tax

The proposal to align the main principles of Section 29 *Income Tax* with IAS 12 *Income Taxes* for the recognition and measurement of deferred tax (see amendment number 44 in the list of proposed amendments at the beginning of this Exposure Draft) is the most significant change being proposed to the IFRS for SMEs.

When the IFRS for SMEs was issued in 2009, Section 29 was based on the IASB’s Exposure Draft *Income Tax* (the ‘2009 ED’), which was issued in March 2009.

However, the 2009 ED was never finalised by the IASB. Consequently, the IASB has concluded that it is better to base Section 29 on IAS 12. The IASB proposes to align the recognition and measurement principles in Section 29 with IAS 12 (see paragraphs BC55–BC60) whilst retaining some of the presentation and disclosure simplifications from the original version of Section 29.

The IASB continues to support its reasoning for not permitting the ‘taxes payable’ approach as set out in paragraph BC145 of the IFRS for SMEs that was issued in 2009. However, while the IASB believes that the principle of recognising deferred tax assets and liabilities is appropriate for SMEs, it would like feedback on whether Section 29 (revised) can currently be applied (operationalised) by SMEs, or whether further simplifications or guidance should be considered.

A ‘clean’ version of Section 29 (revised) with the proposed changes to Section 29 already incorporated is set out in the appendix at the end of this Exposure Draft.

Are the proposed changes to Section 29 appropriate for SMEs and users of their financial statements? If not, what modifications, for example further simplifications or additional guidance, do you propose and why?

We agree with the proposal in the ED to align the section on taxation with the requirements of IAS 12 *Income Taxes*. As we noted in our response to the Board's *Request for Views – Agenda Consultation 2011* however, many people find deferred tax accounting complex to apply and we believe it can produce information of questionable usefulness. We therefore feel that IAS 12 itself needs a rethink at some point in the future. For the avoidance of any doubt though, we would like to stress that we do not favour developing a different model in the IFRS for SMEs compared to IAS 12.

Having made this general point, we would like to draw the Board's attention to some more detailed points, which we have grouped under the headings below:

Offsetting

We would like the revised IFRS for SMEs to include IAS 12's guidance on offsetting. We suggest that it would be better to reproduce the wording from IAS 12.74(b) rather than include an undue cost or effort exemption in a paragraph which refers to intention to settle on a net basis. We expand on why we do not consider an undue cost or effort exemption to be appropriate in our response to question 3 below.

Tax planning opportunities

We would recommend including guidance on tax planning opportunities in the IFRS for SMEs based on IAS 12.30. This could be done by adding the words "Tax planning opportunities are actions that the entity would take in order to create or increase taxable income in a particular period before the expiry of a tax loss or tax credit carryforward" to the end of paragraph 29.17D(b).

Investment property

We also recommend that paragraph 29.21 is expanded to include guidance on circumstances where the presumption that the carrying amount of investment property will be recovered through sale could be rebutted. This could be done by adding the words "This presumption is

rebutted if the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale".

Numbering of this section

We recommend the Board takes the opportunity of revising the IFRS for SMEs to renumber this section of the Standard. We feel that the inclusion of suffixes A, B, etc in the numbering of the paragraphs in this section results in it being harder for the reader to follow the Standard. We would therefore prefer that the Board renumber the whole section when finalising it given that the section has itself been more or less completely rewritten.

Question 3 - Other proposed amendments to the IFRS for SMEs

The IASB proposes to make a number of other amendments to the IFRS for SMEs. The proposed amendments are listed and numbered 1–43 and 45–57 in the list of proposed amendments. Most of those amendments are minor and/or clarify existing requirements.

(a) Are there any amendments that you do not agree with or have comments on?

(b) Do any of the amendments require additional guidance or disclosure requirements to be added to the IFRS for SMEs? If so, which ones and what are your suggestions?

If you disagree with an amendment please state any alternatives you propose and give your reasoning.

The ED proposes to clarify the meaning of 'undue cost or effort' (in Section 2 *Concepts and Pervasive Principles of the IFRS for SMEs*) and also to add related exemptions in a few new areas in the updated version of the Standard. We acknowledge that this concept already exists in the IFRS for SMEs and support the objective of clarifying it.

However, we do have a concern that the clarification proposed will in practice result in a low bar for using the existing and proposed undue cost or effort exemptions – potentially to the extent of them becoming de facto accounting policy choices. Our main reason for saying this is that the key management personnel of SMEs are very unlikely to have a rigorous or verifiable basis for assessing how the decisions of expected users could be affected by the availability of the information in question. We also feel that the ultimate judgement on whether it is appropriate to use such an exemption would often fall on auditors.

For these reasons we also urge caution in further extending the use of undue cost or effort exemptions in this and future revisions. If the Board believes that a proposed accounting treatment will commonly involve costs that exceed the benefits it would be preferable to select a different treatment.

Should the Board nonetheless decide to extend the use of the undue cost or effort exemptions further, we believe it will be very important for the Standard to include rigorous disclosures covering both the fact that the exemption has been used and the justification for using it.

Question 4—Additional issues

In June 2012 the IASB issued a Request for Information (RfI) seeking public comment on whether there is a need to make any amendments to the IFRS for SMEs (see paragraphs BC2–BC15). The RfI noted a number of specific issues that had been previously identified and asked respondents whether the issues warranted changes to the IFRS for SMEs. Additionally, the RfI asked respondents to identify any additional issues that needed to be addressed during the review process. Any issues so identified were discussed by the IASB during its deliberations.

Do respondents have any further issues that are not addressed by the 57 amendments in the list of proposed amendments that they think the IASB should consider during this comprehensive review of the IFRS for SMEs? Please state these issues, if any, and give your reasoning.

We are aware of issues that have been raised in the UK regarding the classification of financial instruments into basic and non-basic instruments.

Specifically, we are aware of concerns that some loans that would usually be considered as 'plain vanilla' loans will be classified as non-basic under the IFRS for SMEs, making the Standard unduly onerous to apply. We therefore recommend the Board addresses these concerns provided it is able to do so in such a way that doesn't complicate the Standard unnecessarily for smaller countries who are less affected by these issues (as we have mentioned in the covering letter we generally favour minimal changes and also feel that bigger countries are likely to have the resources to be able to make changes that they consider necessary for their own local purposes). We describe two particular situations below however that we feel will be applicable to many entities and where we feel that changes should be made to the Standard.

The first situation is where a loan agreement includes a clause designed to protect the creditor against credit deterioration of the borrower and would require the borrower to repay the loan in the event of eg a default, credit downgrade, change in control or violation of a loan covenant. Our reading of the IFRS for SMEs would result in such a loan being classified as non-basic. We suggest the following amendment, to rectify this:

"11.9(c) Contractual provisions that permit the issuer (the debtor) to prepay a debt instrument or permit the holder (the creditor) to put it back to the issuer before maturity are not contingent on future events other than to protect the holder against the credit deterioration of the issuer (eg defaults, credit downgrades or loan covenant violations), or a change in control of the issuer."

The second example is a loan with an early repayment option where early repayment involves a penalty. Our reading of the Standard would cause the loan to be classified as non-basic.

This is because in accordance with 11.9(d) returns to the holder may only be conditional upon variable returns under 11.9(a). Paragraph 11.9(a) does not contain explicit provisions for payments on prepayment.

We note that there is guidance in the IFRS Foundation Education Initiative's training material for the IFRS for SMEs which indicates such a situation does not fail the definition of basic instrument. That material states (emphasis added):

"An option for a debtor to choose to prepay a debt instrument (eg a loan, does not necessarily result in the instrument not meeting paragraph 11.9 (see paragraph 11.9(c)). The prepayment amount must be substantially equal to the unpaid amounts of principal and interest. However, such prepayment provisions may include terms that require the issuer to compensate the holder for the early termination of the instrument."

This guidance is not reflected in the IFRS for SMEs itself however. We therefore suggest wording similar to the above is included in the Standard.

Question 5 - Transition provisions

The IASB does not expect retrospective application of any of the proposed amendments to be significantly burdensome for SMEs and has therefore proposed that the amendments to the IFRS for SMEs in Sections 2–34 are applied retrospectively.

Do you agree with the proposed transition provisions for the amendments to the IFRS for SMEs? Why or why not? If not, what alternative do you propose?

We generally support the Board's proposal to apply the proposed amendments retrospectively.

One area where we feel that transition provisions are needed however is deferred tax. We believe many entities will not have the detailed calculations available to be able to implement the requirements retrospectively, and therefore recommend the inclusion of transition provisions to counter this.

Question 6 - Effective date

The IASB does not think that any of the proposed amendments to the IFRS for SMEs will result in significant changes in practice for SMEs or have a significant impact on their financial statements. It has therefore proposed that the effective date of the amendments to the IFRS for SMEs should be one year after the final amendments are issued. The IASB also proposes that early adoption of the amendments should be permitted.

Do you agree with the proposed effective date and the proposal to permit early adoption? Why or why not? If not, what alternative do you propose?

We agree with the Board's proposal that the effective date should be one year after the final amendments are issued, but would like to express a preference that the date selected should coincide with either 1 January or 1 July (in the same manner that the Board has recently used for new Standards issued under full IFRS).

We note in passing that the ability for early adoption of the revised version of the IFRS for SMEs means that the choice of effective date lessens the significance of this issue from our point of view. We say this because it will, in practice, be very much up to individual jurisdictions to determine their own effective dates.

Question 7 - Future reviews of the IFRS for SMEs

When the IFRS for SMEs was issued in 2009 the IASB stated that after the initial comprehensive review, the IASB expects to propose amendments to the IFRS for SMEs by publishing an omnibus Exposure Draft approximately once every three years. The IASB further stated that it intended this three-year cycle to be a tentative plan, not a firm commitment. It also noted that, on occasion, it may identify a matter for which an amendment to the IFRS for SMEs may need to be considered earlier than in the normal three-year cycle; for example to address an urgent issue.

During the comprehensive review, the IASB has received feedback that amendments to the IFRS for SMEs once every three years (three-year cycle) may be too frequent and that a five-year cycle, with the ability for an urgent issue to be addressed earlier, may be more appropriate.

Do you agree with the current tentative three-year cycle for maintaining the IFRS for SMEs, with the possibility for urgent issues to be addressed more frequently? Why or why not? If not, how should this process be modified?

Please see the covering letter for our views on this question.

Question 8 - Any other comments

Do you have any other comments on the proposals?

We are aware that the UK's Financial Reporting Council (FRC) made a number of detailed amendments when issuing their own version of the IFRS for SMEs for use within the UK. We feel that some of those amendments will be equally relevant in other jurisdictions, and therefore recommend that they are reflected in the IFRS for SMEs.

We have set out the areas of amendments made by the FRC and the specific wording changes suggested in Appendix B to our letter.

Amendments to IFRS for SMEs by FRC

As noted in our response to question 8, the UK's Financial Reporting Council (FRC) made a number of detailed amendments when issuing their own version of the IFRS for SMEs for use within the UK. We feel that some of those amendments will be equally relevant in other jurisdictions, and therefore recommend that they are reflected in the IFRS for SMEs.

We have set out the areas of amendments made by the FRC which we consider equally relevant to other jurisdictions below, together with suggested changes to paragraphs within the IFRS for SMEs.

Section	Amendment made	Paragraph suggested wording
9	Paragraphs inserted to clarify the treatment of a disposal where control is retained, consistent with paragraph 22.19.	<p>Disposal – where control is retained</p> <p>9.19A Where a parent reduces its holding in a subsidiary and control is retained, it shall be accounted for as a transaction between equity holders and the resulting change in non-controlling interest shall be accounted for in accordance with paragraph 22.19. No gain or loss shall be recognised at the date of disposal.</p>
9	Paragraph also inserted to clarify the treatment of an acquisition made in stages.	<p>Acquisition – Control achieved in stages</p> <p>9.19B Where a parent acquires control of a subsidiary in stages, the transaction shall be accounted for in accordance with paragraphs 19.11A and 19.14 applied at the date control is achieved.</p> <p>Paragraph 19.11A is:</p> <p>19.11A Where control is achieved following a series of transactions, the cost of the business combination is the aggregate of the fair values of the assets given, liabilities assumed and equity instruments issued by the acquirer at the date of each transaction in the series.</p>
14 / 15	Amendments to paragraphs 14.9 and 15.14 to require transactions costs to be included as part of the transaction price on initial recognition. Deletions made to be consistent with paragraph 14.8. and 19.11(b).	<p>Fair value model</p> <p>14.9 When an investment in an associate is recognised initially, an investor that is not a parent, that chooses to adopt the fair value model, shall measure it at the transaction price. Transaction price excludes transaction costs.</p> <p>Fair value model</p> <p>15.14 When an investment in a jointly controlled entity is</p>

		<p>recognised initially, a venturer that is not a parent, that chooses to adopt the fair value model, shall measure it at the transaction price. Transaction price excludes transaction costs.</p>
20	<p>Paragraphs inserted to clarify the treatment of operating lease incentives for lessees and lessors.</p>	<p>20.15A A lessee shall recognise the aggregate benefit of lease incentives as a reduction to the expense recognised in accordance with paragraph 20.15 over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset. Any costs incurred by the lessee (for example costs for termination of a pre-existing lease, relocation or leasehold improvements) shall be accounted for in accordance with the applicable section of this FRS.</p> <p>20.25A A lessor shall recognise the aggregate cost of lease incentives as a reduction to the income recognised in accordance with paragraph 20.25 over the lease term on a straight-line basis, unless another systematic basis is representative of the time pattern over which the lessor's benefit from the leased asset is diminished.</p>
32	<p>Paragraphs inserted to provide guidance on the impact of changes in an entity's going concern status.</p>	<p>Going concern</p> <p>32.7A An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.</p> <p>32.7B Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this section requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting and therefore the disclosure requirements of paragraph 3.9 apply.</p>