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31 August 2007

Dear David

**ITC 12: Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of a Proposed IFRS for SMEs**

Grant Thornton Association Inc ("Grant Thornton Australia") is pleased to comment on the Australian Accounting Standard Board's (AASB's) Invitation to Comment on A Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of A Proposed IFRS for small and medium-sized entities (ITC 12 on IFRS for SMEs ED). Our response reflects our position as business advisers both to listed companies and privately held businesses, many of whom would fit within the small to medium-sized entities that either the IFRS for SMEs ED is intended to cover, or are other non-reporting entities which are required to adopt the 'disclosure Standards' issued by the AASB.

This Submission has benefited from input from our clients, Grant Thornton International which will be finalising a global submission to the IASB by its 1 October deadline, discussions with key constituents including the Government, and Public Forums held on this issue. Our general comments are detailed below and comments on the specific issues raised by both the AASB and the IASB are attached (Annexures A and B).

**Support for the Principle of Application of IFRS for SMEs to Reporting Entities that are not Publicly Accountable**

Grant Thornton Australia supports the broad principles of the IASB's proposed IFRS for SMEs Accounting Standard and we believe that the AASB should immediately implement the final Standard and allow retrospective application for reporting entities that are not publicly accountable (i.e. other than listeds, deposit takers etc as per the IFRS for SMEs application proposals).

However, Grant Thornton Australia does not believe that current non-reporting entities including those that file their financial statements with ASIC or grandfathered large proprietary companies, should be required to adopt IFRS for SMEs as the proposals as currently drafted would add significant burden to the simplified financial statements that most non-reporting entities have been following in Australia since 1991.

It would also place Australian SMEs at a competitive disadvantage internationally where in the major capital countries, the financial reporting requirements do not generally require IFRS or equivalent capital markets accounting.

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Such adoption would also be contrary to the Australian Government's Red Tape Reduction Program, and on that basis we do not believe that the AASB has support from a public policy perspective. For such non-reporting entities, Grant Thornton Australia believes that the existing requirements which apply the Australian equivalents of IFRS being AASBs 101, 107 and 108 dealing with financial statement presentation, accounting policies and cash flow statements are appropriate and consistent with what users need (AASB 1031 'Materiality' and AASB 1048 'Interpretations' (for AASBs 101, 107 and 108) also apply). It is up to users to request any additional information, and there is anecdotal evidence that this does occur from time to time. However in the absence of such a request, adoption of IFRS for SMEs would be inappropriate and add significant costs to such non-reporting SMEs.

This view is supported by the record 184 submissions made to the AASB on ED 148 in 2006 where 96% of submissions opposed the reclassification of non-reporting entities as reporting entities. This unprecedented number of submissions (the AASB generally gets less than 10 submissions on EDs) clearly demonstrates in Grant Thornton Australia's view, clear support for the retention of the current Australian Financial Reporting Framework. Notwithstanding the significant public input on this issue, the AASB has determined in ITC 12 that it will require all non-reporting entities that currently file Special Purpose Financial Reports with the Regulator (ASIC), to be defined as reporting entities and by implication covered by the IFRS for SMEs Standard when issued. This is an Australian issue that needs to be resolved before the IFRS for SMEs Standard can be applied in Australia.

Grant Thornton Australia remains supportive of The Institute of Chartered Accountants' Business Practice Guide "...that is designed to provide some assistance for small to medium entities that are non-reporting entities when they are preparing Financial Statements...". A copy of that guide is available at http://www.charteredaccountants.com.au

Whilst Grant Thornton Australia notes that the IASB has left it to individual jurisdictions to determine the applicability of IFRS for SMEs, we believe that it would be contrary to the whole SME reporting philosophy if an individual jurisdiction ignored the intended scope that the IFRS has indicated, and in the Australian context Grant Thornton Australia would not support the adoption of the IFRS for SMEs to current non-reporting entities that usually have less than 50 Employees and who are not producing general purpose financial reports.

Grant Thornton Australia also believes that the IASB and the AASB both need to be clear in comments on 'Micros' (1-3 employees). We believe that in the Australian context very few Micros would be producing general purpose financial reports. Paragraph BC49 of the Basis for Conclusions has rejected Micro accounting and it needs to be clear that this rejection has been on the basis of there being no need for general purpose financial reporting, which in the Australian context, is self evident.

Paragraph BC52 of the Basis for Conclusions notes that some Jurisdictions might apply IFRS for SMEs for small public companies. The AASB will need to consider this Issue, given the high number of small Listed Companies which fall below the current Large Proprietary Company Threshold Tests for public reporting.

Grant Thornton

**The proposed IFRS for SMEs is still far too complex for non-Publicly Accountable Entities**

Grant Thornton Australia is concerned that the IFRS for SMEs ED is too complex for non-publicly accountable entities. This in part may have been due to the development of the ED from a "top down" rather than the "bottom up" approach. The proposed standard should focus on the actual needs of reporting entity SMEs rather than what parts of the full IFRS can be simplified or cut back. In particular we believe that the use of fair values for measurement would generally not be relevant to such entities and instead simplified measurement, recognition and disclosures are needed. We question the practicability of applying the proposed IFRS in a 'typical' small entity with about 50 employees, which is the intended target (BC56). In our experience, most such entities do not have cost-effective access to the level of financial expertise needed to produce financial statements using the Exposure Draft without undue cost and effort. For "micro-entities" of 10 or so employees, this is almost universally so.

**Title for the Standard**

Although the term "small and medium-sized entities" (SMEs) is widely recognised and is used within the IASC Foundation objectives, it does not accurately describe the entities within the scope of the Expose Draft. Consequently, we do not agree that "IFRS for SMEs" is an appropriate title for this proposed set of financial reporting standards.

We disagree that the term "non-publicly accountable entity" (NPAE) implies that smaller entities are not accountable (BC54) and that its current lack of widespread recognition should not preclude its use. The term is clearly defined in the Exposure Draft and its meaning, if properly communicated, should quickly become widely recognised. We recommend the title reverts back to "IFRS for non-publicly accountable reporting entities". Alternatively, the title could be "IFRS for Private Reporting entities", as long as "private entities" are defined in the same way as NPAEs are now.

**Regulatory impact of the proposed changes as part of its consultation process**

The AASB should publish a regulatory impact study of its proposed changes and issue this as part of its due process. The lack of impact analysis concerning the expansion of reporting requirements beyond current 'reporting entities' is a major drawback of the AASB's ITC.
If you have any questions on our response, or wish us to amplify our comments, please contact me.

Yours sincerely
GRANT THORNTON ASSOCIATION INC

KEITH REILLY
National Head of Professional Standards

**Annexure A - AASB Specific Matters for Comment**

(a) *do you agree with changing the application focus of Australian Accounting Standards from 'reporting entity' to 'general purpose financial reports'?*

No, we do not support the AASB's tentative decision to replace the reporting entity term. It is inconsistent with the IASB's own use of that term which is also part of the IASB's Conceptual Framework Part D reporting entity discussion paper which is due for release in late 2007.

(b) *if it is considered desirable to retain the reporting entity concept as the basis for differential reporting, what improvements could be made to remove related concerns (see paragraph BC6) and make it more effective?*

Yes, we believe it is strongly desirable to maintain the reporting entity concept. In particular we disagree with the analysis in Para BC6 of ITC 12 which we believe is fundamentally flawed.

- BC6 (a) As stated in (a) above, the 'reporting entity concept is used internationally as it is the basis for the definition of who produces 'general purpose financial reports'.

- BC6 (b) The IASB's IFRS for SMEs ED is specifically not intended to be applied to non-reporting entities.

- BC6 (c) We accept that there is some difference of opinion on the particular AASB Standards that need to be applied by non-reporting entities. We remain of the view that the current scope paragraphs in the AASB Standards make it clear that it is only the 'disclosure' Standards that are mandatory for Chapter 2M.3 of the Corporations Act"(a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act". We also support basic recognition and measurement criteria that are contained in the Institute's Business Practice Guide. Whilst we note that ASIC has a view that the recognition and measurement requirements of all of the AIFRS/IFRS Standards should be applied, we understand that smaller non-reporting entities do not follow that view given the complexity of the current AIFRS/IFRS requirements which has now been recognized by the IASB's ED IFRS for SMEs.

- BC6 (d) We see no confusion on the specific requirements of the application clauses of the AASB Standards and this is acknowledged in the Background to ITC 12 'entities incorporated under the Corporations Act (page vii) which states:

  "Entities incorporated under the Australian Corporations Act 2001 that are reporting entities currently have to comply with all the recognition, measurement and presentation and disclosure requirements of Australian Accounting Standards and Australian Interpretations (which include Australian equivalents to IFRSs). Incorporated entities that are not reporting entities but are required to prepare financial statements must comply with AASB 101 Presentation of Financial Statements, AASB 107 Cash Flow Statements and AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors, and also AASB 1031, Materiality and AASB 1048 Interpretation and Application of Standards.

  We note that paragraph (c) of the AASB Accounting Standards only trigger general purpose financial reports where such reports:...are, or are held out to be, general purpose financial reports.". We do not believe that entities that are preparing or filing Chapter 2M financial reports are being 'held out' to be general purpose financial reports where there is a clear statement that the financial report is special purpose.

We have also confirmed with the Government that its amendments to the size threshold tests for Large Proprietary Companies (Simpler Regulatory Act 2007) did not intend that filing financial statements with ASIC would trigger the reporting entity concept and consequently the need to prepare general purpose financial reports.

- BC 6 (e) We do not believe that there is any confusion as to the use of the reporting entity concept, until the release of ITC 12.

(c) *do you support the proposal to apply the IASB's definition of a publicly accountable entity to differentiate between for-profit entities that apply Australian equivalents to IFRSs and for-profit entities that apply an Australian equivalent to the IFRS for SMEs?*

Yes but we do not support the AASB extending the reach of IFRS beyond the IASB's publicly accountable entity based on size threshold tests

(d) *in respect of for-profit entities that do not satisfy the IASB's definition of a publicly accountable entity, but are viewed as being important from a public interest perspective because of their large size:*

(i) *do you agree that such entities should in the public interest apply Australian equivalents to IFRSs and that it is appropriate to use size thresholds to identify these entities?*

No, as we question the AASB's criteria on how it has determined 'public interest'.

(ii) *do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds, and why?*

No, we do not agree with the proposed size threshold tests. We remain of the view that the IASB's definition of publicly accountable should be the appropriate criteria for triggering full IFRS application. To do otherwise would not be consistent with the IFRS Framework.

(e) *since the IASB's ED of A Proposed IFRS for SMEs has been developed with only for profit entities in mind, do you agree it is appropriate to adopt the forthcoming IASB's IFRS for SMEs (after inclusion of Aus paragraphs similar to those included in Australian equivalents to IFRSs) in a differential reporting regime in respect of not-for-profit private sector entities and public sector entities?*

Yes, however it does need to be modified to ensure that specific not-for-profit and other public sector characteristics are taken into account, in the same way the IFRS is modified where appropriate for such entities.

(f) *in respect of not-for-profit private sector entities:*
(i) *is there a need for differential reporting in the not-for-profit private sector?*

Yes, as there are SMEs that do not have the characteristics of publicly accountable, and non-reporting entities where IFRS for SMEs is not appropriate.

*If yes, do you agree with using size thresholds to distinguish between not-for-profit private sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the*

*IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalent to IFRSs)?*

No, we do not support a differential size test as this is not consistent with the philosophy behind the IASB's ED. Instead we believe that the publicly accountability test and the non-reporting entity tests should apply. For the private not-for-profits (NFPs) such as Charities, we continue to support sector specific Standards and Guidance as there is accountability and stewardship rather than an economic decision making interest by users of the financial and non-financial information in a financial report.

(ii) *do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate size thresholds and why?*

No, we do not agree with using a size threshold test.

(iii) *not-for-profit entities that meet the thresholds of $25m revenue and $12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of $500m revenue and $250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of not-for-profit entities. Do you agree?*

No, we do not agree with the differentiation between not-for-profit entities and for-profit entities.

(iv) *both private sector not-for-profit entities and public sector entities that meet the thresholds of $25m revenue and $12.5m assets would need to prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?*

No, we do not agree with this differentiation and instead believe that the publicly accountability test and the non-reporting entity test should apply.

(v) *do you think a third tier of simpler reporting requirements should be added to cater for smaller not-for-profit private sector entities that prepare general purpose financial reports? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified? How would your answer to this question differ if the forthcoming IFRS for SMEs has fewer disclosures than the ED of A Proposed IFRS for SMEs?*

No, we do not support a third tier of simpler reporting requirements for reporting entities that are preparing general purpose financial reports. However we do strongly support the retention of the reporting entity concept which for non-reporting entities is effectively a third tier of simpler reporting requirements for smaller for-profit and not-for-profit entities. For non-reporting entities we support the existing AASB disclosure requirements and could envisage some more simplified disclosure arising from the IFRS for SMEs Standard, without however the complex fair value recognition and measurement requirements of the current IFRS for SMEs ED. We continue to support the current reporting regime that applies in Australia but with inclusion of the Institute's Business Practice Guide for simplified recognition and measurement.

*(g) in respect of public sector entities:*

*(i) is there a need for differential reporting in public sector?*

Yes, we support differentiation based on the IASB's tests of public accountability and the reporting entity concept (i.e. general purpose financial reports).

*If yes, do you agree with differentiating based on size thresholds between public sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalents to IFRSs)?*

No, we do not support a differential size test as this is not consistent with the philosophy behind the IASB's ED. Instead we believe that the publicly accountability test and the non-reporting entity test should apply.

*(ii) do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds and why?*

No, we do not support a differential size test as this is not consistent with the philosophy behind the IASB's ED. Instead we believe that the publicly accountability test and the non-reporting entity test should apply.

*(iii) public sector entities that meet the thresholds of $25m revenue and $12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of $500m revenue and $250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of public sector entities. Do you agree?*

No, we do not support a differential size test as this is not consistent with the philosophy behind the IASB's ED. Instead we believe that the publicly accountability test and the non-reporting entity test should apply.

*(iv) both public sector entities and not-for-profit private sector entities that meet the thresholds of $25m revenue and $12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?*

No, we do not support a differential size test as this is not consistent with the philosophy behind the IASB's ED. Instead we believe that the publicly accountability test and the non-reporting entity test should apply.

*(v) do you think another tier of simpler reporting requirements should be established to cater for smaller public sector entities? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified?*

No, we do not support a third tier of simpler reporting requirements for smaller Public Sector reporting entities that are preparing general purpose financial reports. However we do strongly support the retention of the reporting entity concept for smaller Public Sector non-reporting entities we support the existing AASB disclosure requirements and could envisage some more simplified disclosure arising from the IFRS for SMEs Standard, without however the complex fair value recognition and measurement requirements of the current IFRS for SMEs ED. We continue to support the current reporting regime that we suggest could apply in Australia but with inclusion of the Institute's Business Practice Guide for simplified recognition and measurement.

(h) *do you think there are approaches, other than the proposed approach based on public interest and employing size thresholds, that would reasonably distinguish between entities that should apply the Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs? If there are appropriate alternative approaches, please explain.*

Yes we believe that the proposed IASB public accountability test should be the only differentiation along with the application of the reporting entity concept.

(i) *do you agree that, consistent with the IASB's view of a general purpose financial report, under a revised Australian differential reporting regime:*

(i) *all financial reports that are available on a public register, such as those prepared and lodged with the ASIC under the Corporations Act, should be regarded as general purpose financial reports; and*

No, we strongly disagree with the AASB's tentative view as expressed in ITC 12 that because an Entity lodges financial statements on a public register, it is automatically a reporting entity that is required to prepare general purpose financial reports. This is in fact supported by the IASB with its scope application, as well as the previous Submissions made to the ASB on ED 148.

(ii) *all financial reports that are made available to the public at large, such as those tabled in a Parliament, also should be regarded as general purpose financial reports? If you do not agree, explain why.*

No, we also strongly disagree with the AASB's tentative view as expressed in ITC 12 that because an Entity makes its financial statements publicly available, it is automatically a reporting entity that is required to prepare general purpose financial reports. It will depend on whether there are users of the financial statements that are publicly available.

(j) *do you agree that, notwithstanding an entity having been exempted from filing a financial report with the ASIC, its financial report should be regarded as a general purpose financial report if it is required by the Corporations Act to be prepared in accordance with Australian Accounting Standards?*

No, we disagree with the proposal that mere preparation of financial statements automatically triggers general purpose financial reports. The Government has clearly allowed for grandfathering to continue, and it is on the basis that the financial statements are clearly not publicly available.

(k) *the Corporations Act includes three size thresholds respectively for revenue, assets and the number of employees to distinguish between small and large proprietary companies. The AASB's proposed size thresholds only include the monetary thresholds of revenue and assets. Do you think that, except for the case of for-profit entities that are not publicly accountable but are important from a public interest perspective, a further size threshold for the number of employees would be appropriate under the proposed differential reporting for not-for-profit private sector entities and public sector entities?*

No, we do not see the need to include an Employee test, but in any case we are opposed to size tests and prefer the publicly accountability and reporting entity tests to be applied as the IASB has intended in its IFRS for SMEs ED.

(l) *considering the AASB's tentative decision to base the second tier of reporting requirements on the IASB's pending IFRS for SMEs, do you consider that the IASB's ED of A Proposed IFRS for SMEs is appropriate for Australian circumstances. If not, explain how it could be improved, or what other options are more appropriate and why?*

(i) Yes for reporting entities although we believe that the IASB's ED should be significantly amended to reduce the measurement and recognition requirements that are just not needed for reporting entity SMEs.

(ii) No for non-reporting entities as the existing AASB disclosure Standards are all that is required for non-reporting entities.

(m) *do you think adaptations, or additional guidance, are needed (in addition to Aus paragraphs that would be included consistent with Australian equivalents to IFRSs) for not-for-profit private sector entities and public sector entities if the IASB's IFRS for SMEs were adopted in Australia?*

Yes, for the reasons that the AABS has such inclusions for IFRS.

(n) *do you think Australia and New Zealand should seek to achieve harmonisation in their reporting requirements regarding SMEs?*

Yes, we are supportive of harmonization of financial reporting, assurance and legislative requirements.

(o) *are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the preliminary views?*

Yes, Grant Thornton Australia remains concerned about the exact applicability of the IFRS for SMEs Standard when issued. In Grant Thornton Australia's view, the IASB's definition of 'public accountability' should not be varied for Australian reporting entities, without clear justification. We also strongly recommend that the reporting entity concept be maintained as smaller SMEs should not be required to adopt the IFRS for SMEs model.

The not-for-profit sector generally needs special consideration given that IFRS and IFRS for SMEs is directed at reporting entities in the Private Sector. For those non-reporting Not-for-Profit entities, application of either IFRS or the IFRS for SMEs Standard is not justified, given that the Standards are not intended for such entities.

Grant Thornton Australia notes the AASB's concern that some of the disclosures in the IFRS for SMEs ED might be too onerous and therefore a third tier of reporting with reduced disclosures might be necessary. However in Grant Thornton Australia's view it is the measurement and recognition tests in the ED that specifically need to be simplified and not just the disclosures. Grant Thornton Australia remains of the view that a better solution would be to maintain the non-reporting entity concept for the smaller SMEs.

*(p) do you think that the overall benefits that would arise from the proposals would exceed the overall costs?*

No, if the AASBs ITC 12 Proposals remain, we would not support the introduction of the IFRS for SMEs as the costs of dismantling the reporting entity concept and forcing such entities to significantly increase the costs of producing financial statements are clearly in excess of the benefits of reduced costs for non-publicly accountable reporting entities. However we do support the introduction of the IFRS for SMEs Standard for reporting entities and believe that the benefits would clearly exceed the costs of the IFRS for SMEs Standard given simplified recognition, measurement and disclosure requirements that apply, compared to the existing IFRS requirements for reporting entities.

*If you are an entity that prepares a general purpose financial report or would need to do so under the proposals, please advise us of any increased costs or any savings that would result from the proposals, and if possible, quantify them.*

We estimate that for a current non-reporting entity to move from the AASB disclosure Standards to the proposed IFRS for SMEs ED, it would cost at least an extra $15,000 or more.

*(q) would the preliminary views be in the best interests of the Australian economy?*

No, Grant Thornton Australia does not support the application of the IFRS for SMEs ED to current non-reporting entities as that is clearly outside the IASB's intention with the current ED, and would be contrary to the Australian Government's Red Tape Reduction Policy. However for reporting entities that are non publicly accountable, we do support the IFRS for SMEs ED.

## Annexure B - IASB Specific Matters for Comment

### *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?*

Grant Thornton Australia questions as a fundamental Issue whether the simplification of measurement is sufficient for an SME particularly given the Australian experience of implementing IFRS where the use of fair values has proved both difficult and time/cost consuming. As an alternative if our views are not accepted, we would support extending the agriculture industry scoping that fair value need only be used where that fair value is reliably determined without undue cost or effort (BC86).

In addition Grant Thornton Australia questions whether the IASB has over-stated the users of SME Financial Statements. Grant Thornton Australia from its 15 years experience with the reporting entity concept is of the view that most lenders, major creditors and prospective Investors do not rely just on the Financial Statements but rather do their own due diligence which will often include individual Guarantees from the Company and its Directors/Executives. Whilst the Financial Statements are a trigger test, simplification of measurement would not be misleading for such usage. Grant Thornton also believes that small Creditors and Employees would not generally rely upon Financial Statements as any deterioration in Solvency will be obvious well before Financial Statements that are dated 6 months earlier, are utilized.

1.1. We believe that the standard should be a stand-alone document with no mandatory cross-references to full IFRS. Cross-referencing obliges the users of the IFRS for SMEs to have knowledge of two sets of standards and to keep fully up to date with developments in full IFRS as well as the IFRS for SMEs.

1.2. Generally, where the Exposure Draft includes transactions only by specific cross-reference to full IFRS, the Board should consider whether sufficient number of SMEs would enter into these transactions to warrant inclusion in the IFRS for SMEs. If not, then the cross-reference should be omitted. This would allow the few entities that enter into the transactions to follow the general hierarchy for selecting accounting policies in section 10 (see comment, next paragraph). If sufficient numbers of entities enter into the transactions so as to merit inclusion in the IFRS for SMEs, the cross-reference to full IFRS should be replaced by the explicit treatment/disclosure requirements, simplified where possible to suit the requirements of SMEs.

1.3. We believe the hierarchy contained in the Exposure Draft (paragraph 10.2) forms a suitable basis for developing appropriate accounting policies for transactions not covered by the standard, without mandatory fall back to full IFRS. Although full IFRS is clearly a useful source of guidance to inform thinking on appropriate application of principles to specific transactions, the general hierarchy will provide the flexibility needed to ensure the policy selected is suitably tailored to the cost-benefit analysis of the SME entity and the users of its financial statements.

1.4. Where transactions are included in the Exposure Draft, but only the simple option is included and a cross-reference to full IFRS permits a more complex option, we believe the Board should take this opportunity to review the need for and suitability of the complexity of these options for SMEs. As noted in the main body of our response, we do not agree that all options available to entities using full IFRS need to be available to SMEs. Where an alternative to the simple treatment is considered appropriate, it should be included in the IFRS for SMEs and expressed in a simplified form suitable for smaller entities (see our response to question 4 below).

1.5. We understand that for the IFRS for SMEs to be a stand-alone document and for all suitable options to be available, the standard will increase in length. We believe that a self sufficient document is of substantially greater value to the user than a document which requires knowledge of other texts. We also believe that the length of the standard could be significantly reduced by deleting or simplifying requirements that are too complex for the requirements of an SME (see our response to question 4 below). Also, the structure of the document could improve ease of use by providing the simple "benchmark" options in the main body of the standard with the more complex options contained in an appendix (see our suggestions on improvements to the style and format of the document in the main body of this letter).

1.6. Mandatory cross-referencing to full IFRS also introduces an element of instability into the IFRS for SMEs. If such cross-references are retained, the Board needs to make clear the status of IFRIC interpretations and the status of changes to full IFRS where there is a time lag before the IFRS for SMEs is updated. Although the preface to the Exposure Draft refers in P16 to changes where there are specific requirements in the IFRS for SMEs, this does not seem to address direct cross-references to full IFRS.

***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.*

As detailed in comment 1, Grant Thornton Australia believes that the requirement to fair value transactions adds significant costs with few benefits for SMEs. Instead Grant Thornton Australia advocates a simple Impairment Trigger Test with the use of historical cost as the measurement base.

1.7. Section 11 on financial instruments proposes that fair value measurement is to be used unless the instrument fits the criteria to measure at amortised cost. Lengthy criteria and examples are then given to demonstrate what instruments might be measured at amortised cost. It would be simpler and less costly to allow amortised cost as the default and require fair value measurement only when fair value is "readily determinable" and the cost of obtaining a valuation is outweighed by the benefits to users who, as noted above, are often more interested in cash generation than valuation.

1.8. The Exposure Draft uses the phrases "measured reliably" and "reliable estimate". In full IFRS, there is an assumption that values will normally be capable of reliable measurement or estimation, eg IFRS 2.24 states that it would be "rare" that an entity could not reliably estimate the fair value of equity instruments granted. Appendix B to section 11, which repeats substantially the same wording as IAS 39 Application Guidance AG69 - 82, provides some useful guidance on fair value measurement considerations. However, this guidance also assumes that fair values can be reliably measured without any concept or consideration of whether the values or inputs to valuation techniques are "readily determinable without undue cost or effort". This phrase is used in the Exposure Draft at 35.1 (and BC86 and BC103) relating to biological assets, but is not defined. Similarly, there is an acknowledgement in the share-based payment section in 25.4 (and in BC91, which itself is directly cross-referenced to IFRS 2) that entities may not be able to reliably measure the fair value of equity instruments issued and so may use the intrinsic value instead.

1.9. It would therefore be helpful for the Board to explain when it considers that fair values ought to be "readily determinable without undue cost or effort". This should include an indication of when the inputs need to incorporate observable market values or a professional valuation or can be a reasoned internal estimate. Throughout the IFRS for SMEs, cost (less depreciation and impairment) or amortised cost (less impairment) ought to be used unless fair values are "readily obtainable without undue cost or effort".

1.10. The requirements for derecognition of financial assets in section 11.24 et seq. are expressed more simply than in IAS 39 but are still complicated. It would be better to express the clear examples first and then describe the details to assist with clarity and understanding.

1.11. As noted above, we do not support the maintenance of all options available in full IFRS being available to those using the IFRS for SMEs. We believe that, as far as is practicable, a simple "benchmark" treatment should be provided. Only if an alternative treatment can be justified on the grounds of user-needs within appropriate cost-benefit constraints should another option be included. Similarly, the likelihood of take-up of the alternative treatment should be considered. For example, in our experience, hedge accounting is rarely used in practice due to the extensive documentation and testing required. This may be an area that the Board could consider deleting from the IFRS for SMEs on the grounds of limited relevance in practice. If the Board consider that the hedge-accounting option would be relevant to sufficient users and preparers of SMEs financial statements, then it should provide a simplified version of the option. If hedge accounting is retained, then its use should not be restricted to only to the types of hedges described in the

Exposure Draft but should be available to all genuine hedge transactions. It would be helpful if the documentation and the effectiveness testing needed could be explained in a simple manner. This could be done in an Appendix to the section to prevent "cluttering" the main section.

1.12. As an alternative to general hedging requirements, it may be useful to permit some commonly used specific hedging transactions to be accounted for in a way that recognises the specific hedge, eg foreign currency transactions could be recorded at their foreign exchange contract (FEC) rate where the FEC is taken out for a specific transaction already entered into. This would normally provide an "automatic" hedge in the financial statements. If any hedging rules are retained, it should be made clear that 11.30 only requires designation and documentation by the time of preparing the financial statements.

***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?*

1.13. We believe that the Board should reconsider the treatment of equity-settled share based payments. As noted above, we believe that the IFRS for SMEs should be a stand-alone document without mandatory cross-reference back to full IFRS. The specific requirements of full IFRS should be brought into the IFRS for SMEs only when necessary. Where possible, the requirements included should be expressed in a simplified form to reflect the different needs of users of general purpose financial statements for SMEs.

1.14. We agree with the observation in BC59 that it is uncommon for SMEs to enter into equity-settled share based payment arrangements. We also believe that a reliable estimate of fair value of the equity instrument is unlikely to be readily available without undue cost or effort on an ongoing basis. (In most cases, the fair value of the underlying share is only routinely estimated at the time of grant of the instruments but is not subsequently remeasured, except on exercise. This remeasurement on exercise is often carried out for taxation purposes.) Consequently, even the intrinsic value approach could be costly and time consuming for SMEs without sufficient added benefit to users.

1.15. Disclosure of the nature of the share-based payment and its measurement at grant and at exercise should provide users with sufficient information to identify the value of the award to the employees and the impact on the entity. We therefore suggest that the measurement and recognition requirements in the Exposure Draft (achieved by cross-reference to IFRS 2) be removed and replaced by disclosure requirements only.

### *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 recognised 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? Should 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?*

1.16. We do not agree with the comment in BC108 that the benefits of comparability between SMEs and entities applying full IFRS outweigh the benefits of simplicity and greater comparability between SMEs. We support the Board's conclusion expressed in BC26 that the differences in the types and needs of users of SMEs' financial statements are sufficiently different from the market-driven needs of publicly-accountable entities using full IFRS to warrant a separate set of standards. It does not seem to be consistent to conclude that comparability between users of SMEs financial statements and users of financial statements of entities using full IFRS is more important than comparability between SMEs. The requirements of the IFRS for SMEs should therefore stay focused on the needs of users of SMEs financial statements and be tailored appropriately.

1.17. As noted above, where options are retained (whether in a simplified form or in the same form as full IFRS) consideration should be given to their relevance (eg the lack of observed usage of hedge accounting or of revaluation of intangible assets may provide grounds to eliminate these options). An alternative to elimination is to include them but with simplification of the requirements to make them easier to understand and apply.

1.18. There may be a small number of SMEs that would want to use the full IFRS treatment without modification, eg some subsidiaries of entities applying full IFRS. However, we do not believe that the desires of a potentially small number of constituents should add complexity for the majority of users. We agree that the ability of SMEs to revert to full IFRS on a principle by principle or standard by standard basis is undesirable (BC117 & 118). However, we believe that the current cross-referencing proposals in the Exposure Draft do permit this piecemeal reversion to full IFRS. In our view, entities that want to retain all options within full IFRS will still have access to them but should be given access by use of full IFRS, unless jurisdictions exclude the use of full IFRS for entities within the scope of the IFRS for SMEs.

### *Question 5 – Borrowing costs*

*IAS 23 Borrowing Costs currently allows entities to choose either the expense model or the capitalisation 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 capitalisation model. Section 24 Borrowing Costs of the draft IFRS for SMEs proposes to allow SMEs to choose either the expense model or the capitalisation model.*

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

1.19. We agree. The expense model is more appropriate and cost-effective for the majority of SMEs and so is a suitable simplification to retain.

### *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?*

1.20. As noted above, would prefer to see the IFRS for SMEs be "stand-alone" and so specific mandatory cross-references to full IFRS should be deleted. If it is considered that sufficient number of SME entities will enter into transactions, eg lessor accounting for finance leases, then requirements should be built into the standard (preferably in a simplified form). If such requirements are considered applicable to too few entities to require inclusion in the IFRS for SMEs then they should be omitted and the fall-back should be the general hierarchy for transactions not covered by the standard.

1.21. Currently the sections on Segmental Reporting, Earnings Per Share and Interim Financial Statements (sections 31, 34 and 37) require full compliance with the full IFRS standards via specific cross-reference. There is no option to provide disclosures outside these full IFRS requirements. This is considered unhelpful and will act as a barrier to useful information being provided on a voluntary basis. Some SMEs may wish to provide some information in these areas, especially relating to segments, but would want flexibility regarding the format and detail of the disclosures. This could be done by presenting the information outside the financial statements, e.g. in a business review, but we feel that this would reduce reliability and effectiveness of the information. We outline below some suggestions as to how this area could be dealt with:

1.21.1. The IFRS for SMEs could include a general section on voluntary disclosures that could outline guidance for reliability and consistency of information. Example disclosures can be demonstrated in Implementation Guidance accompanying the standard.

1.21.2. Requirements relating to areas unlikely to be addressed by SMEs could be omitted, e.g. interim reports, as they would be sufficient covered by the general guidance.

1.21.3. Requirements for the measurement of e.g. EPS may be needed to ensure comparability with EPS figures presented in accordance with full IFRS, as this may be an area where users would assume such comparability of measurement.

1.21.4. Clear disclosure of the basis of preparation of voluntary disclosures should be required so that readers can make an assessment of its reliability and comparability.

### *Question 7 – General referral 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?*

1.22. We consider the hierarchy within section 10 of the Exposure Draft to be appropriate and useful. As noted above, a mandatory fallback to full IFRS not only creates added complexity to the IFRS for SMEs but creates uncertainty as to the status of IFRIC interpretations and changes to cross-referenced full IFRS that fall between IFRS for SME updates and cross-references to other IFRSs within the cross-referenced IFRSs (including scope sections). However, the elimination of a requirement for mandatory fall back to full IFRS means that extra care needs to be taken in deciding what transactions can be omitted from the IFRS for SMEs. This should be based on relevance, ie how many SMEs are likely to be involved in such transactions and a cost/benefit analysis - does the benefit of applying a specified treatment outweigh the costs of both including the material in the IFRS and the cost of applying it.

1.23. The explicit cross-references back to full IFRS should be deleted and replaced where appropriate with specific (simplified) requirements.

### *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?*

Grant Thornton Australia believes that Guidance will be welcomed and it is noted that such Guidance is consistent with the Guidance contained in the Institute's Business Practice Guide that provides similar assistance for SMEs in choosing Accounting Policies to follow.

1.24. Some respondents might argue that if the requirements of the IFRS for SMEs are sufficiently clearly written, then no further guidance should be needed. However, we believe that it would be helpful to include some recognition and measurement guidance, demonstrating calculations and accounting entries. These could be based on those currently included in full IFRS but would in some cases benefit from additional explanatory notes. This guidance should be included in the Implementation Guidance section of the IFRS for SMEs, clearly cross-referenced to the main body of the standard to assist clarity.

### *Question 9 – Adequacy of disclosures*

*Each section of the draft IFRS for SMEs includes disclosure requirements. Those requirements are summarised 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?*

We consider the proposed disclosures requirements to be at an appropriate level.

### *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?*

1.25. It would be helpful to have more guidance on business combinations, as is done in IFRS 1 *First-Time Adoption of International Financial Reporting Standards.*

1.26. Also, more guidance on "deemed cost" is needed, ie when it can be used and what measure is appropriate.

1.27. More clarity and guidance is needed on deferred tax. It is not clear why an exemption is proposed - in what circumstances would the tax base or carrying value not be identifiable? Does the exemption apply at the transition date or also at each subsequent balance sheet date?

### *Question 11 – Maintenance of the IFRS for SMEs*

*The Board expects to publish an omnibus exposure draft of proposed amendments to the IFRS for SMEs approximately every other year. In developing such exposure drafts, the Board expects to consider new and amended IFRSs that have been adopted in the previous two years as well as specific issues that have been brought to its attention regarding possible amendments to the IFRS for SMEs. On occasion, the Board may identify a matter for which amendment of the IFRS for SMEs may need to be considered earlier than in the normal two-year cycle.*
*Is this approach to maintaining the proposed IFRS for SMEs appropriate, or should it be modified? If so, how and why?*

1.28. We agree the proposed approach is appropriate on the grounds given in BC127.

1.29. However, we find much merit in the comment in BC126 that the consistency of consideration achieved by contemporaneous consideration of changes to the IFRS for SMEs is a substantial benefit. It would be helpful if the Board could publish their views as to how they believe the publication of new or amended standards and interpretations should impact the IFRS for SMEs at the same time such publications are issued. This could take the same form as the IASB Annual Improvements Project. Although comments are only sought from constituents on an annual basis on the "collected proposed amendments", their ongoing publication throughout the year allows for more timely consideration.

1.30. Publication of a basis for conclusions in support of all decisions to include, exclude or amend requirements in new/amended full IFRS from the IFRS for SMEs would be helpful.

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