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By Email: CommentLetters@iasb.org

Re: Exposure Draft of International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)

Dear Paul,

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the IASB's Exposure Draft of the IFRS for SMEs. CGA-Canada is a leading accounting organization with 68,000 members and students in Canada and internationally. Any proposals leading to development of new or amendments of existing standards are of considerable interest to all our members.

In the spirit of informing our response, several roundtable meetings were held with CGAs in July of this year. This response includes the results of those meetings in addition to subsequent research and analysis by CGA-Canada.

We will preface our discussion with an overall general comment and general remarks, then proceed to provide direct comments to 11 specific questions (***bold italics***) posed by the Board, provide other minor observations of the IFRS for SMEs Exposure Draft (ED) and, lastly, present our conclusion.

Overall General Comment

The IFRS for SMEs is an excellent document; it provides substantial information; it is well-organized, well-indexed, and most terms are well-defined. All things taken together, the IFRS for SMEs is simpler than full IFRSs – a necessary condition if it is to be embraced by SMEs.

General Remarks

We do, however, have two general remarks:

1. General Purpose Financial Statements (GPFS)

The general purpose financial statements must exhibit characteristics including those of relevance, clarity, accuracy, comprehension, and completeness. The statements must provide decision-useful information needed by all types of users, e.g. equity investors, rating agencies, lenders/creditors, suppliers of risk capital (e.g. venture capital), and other stakeholders such as existing or prospective customers, suppliers and employees. The statements specifically prepared for a regulatory agency such as the Canada Revenue Agency (CRA) (the tax authority in Canada) would not be a GPFS.

The major difference between publicly accountable and non-publicly accountable entities is the number of shareholders and whether those shares are traded freely on a stock exchange. Naturally also, publicly accountable entities are subject to debt rating and more extensive investment analysis. Understandably though, there is academic and practical attraction to nevertheless maintain a high level of accountability within the statements and in pursuing the desirable characteristics earlier identified. For example, in a non-publicly accountable entity or in a small publicly accountable entity, a prospective employee or supplier could typically base business decisions on the entities' financial ability and disclosure.

Generally, the concept of "significant external users" is advanced. On the premise that there are no significant external users, the statements are oftentimes permitted to have a lesser amount of accountability and will typically fail to satisfy sought or desirable characteristics. Many argue that 80 per cent of SMEs prepare reports for owners/managers, bankers, and tax authorities and those owners/managers provide personal guarantees for loans. Many contend therefore that such entities should not be required to prepare GPFS. Our reservation is that this argument does not give due accountability and consideration to other prospective stakeholders including successors and parties to contractual assignments. We concede that other stakeholders, as referred to above, are typically not defined as external users but assert that this may not be an optimal state; perhaps even short-sighted given that these entities evolve, mature and transform over a life time and could benefit from increased access to, and veracity of, financial information.

Some argue that the financial statements of SMEs are prepared for lenders and not for investors. We believe that GPFS are prepared for all stakeholders including minority shareholders and prospective venture collaborators.

Not-for-profit companies, although in general not recipients of public contributions per se, are required to produce general purpose financial statements. We believe that IFRS for SMEs are a reasonable option. We believe also that IFRS for SMEs afford charities, which do receive contributions from public, a reasonable reporting regime.

2. Evolving from a small to large SME or to a small/large listed company

Generally, most SMEs start as small/micro entities. While owners are relatively modest, many silently hope to someday render their entity a larger, even listed entity. Depending on managerial capacity and the business plan, an entity may remain a small entity for a long time or in some cases never become a large SME or listed company. The owners of such entities, if asked, are likely to respond that they don't wish to become a large or a listed company, but these men and women are entrepreneurial and will oftentimes harbour aspirations which are inconsistent with the public modesty which they wish to portray.

As humans exhibit such hope, a case may be made that they should prepare GPFS and follow IFRS for SMEs. It is beneficial for some of the reasons cited above but serves also to facilitate migration to full IFRS as the entity transforms and evolves. And even when an owner is not attracted to such growth, such companies may someday encounter a competitor which is a listed company or uses IFRS for SMEs. Therefore, for such a company, even to analyse the financial statements of the competitor, the knowledge of the IFRS for SMEs is beneficial. If so, then why might we assume that owner-managers are uninterested to prepare their own statements using IFRS for SMEs?

Also, our research revealed that the smaller companies listed on the Toronto Stock Exchange have market capitalization of less than \$5 million and a total asset base of less than \$6 million. Conversely, one of the largest non-listed companies in Canada has total sales of \$6.3 billion, total assets of \$3.1 billion, and an employee count of 29,000 strong. Are we to conclude that this non-listed company has less public accountability than the smaller listed company?

It can be argued that on a cost/benefit basis, micro-entities should not be required to prepare GPFS. The European Union defines a micro entity as one which has less than 10 employees and less than \$3 million assets¹. Our research determined that the TSX (Toronto) Venture Exchange in Canada posts several listed companies having assets of less than \$400,000. Clearly, they are micro-listed companies. If micro-listed companies are required to produce GPFS, it is reasonable that micro-unlisted companies of perhaps greater magnitude should be. Or do we now mean micro-micro entities? Admittedly, these arguments can all become circular but we

¹ "Tackling Compliance: Small Business and Regulation in Canada", 2006, Rock Lefebvre and Phil Gans, Certified General Accountants Association of Canada; accessible on CGA website.

are reasonably confident that the case for IFRS for SMEs has been made and that it can apply across a vast spectrum.

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?

We would like to note here that a financial transaction that is applicable to a SME would also be applicable to a listed company and vice versa.

The IASB really has two options; 1. Include in IFRS for SMEs all the missing standards if they are available to any type of SME and remove cross-referencing or 2. Refer to the full IFRS for applicable standards.

The CGA program of studies is continually updated with latest concepts, ideas and theories related to accounting and assurance and practitioners' practices and standards. We expect to have completely integrated the introduction of full IFRS into the curriculum by the time the Canadian Accounting Standards Board (AcSB's) moves from domestic to full IFRS in 2011. By this date, our new members will be knowledgeable of the full IFRS. Through our emphasis on mandatory Continuing Professional Development (CPD), we anticipate that our current members would also be fully conversant with the full IFRS.

Since the IFRS for SMEs is a derivative of the full IFRS requiring only the simpler options from the full IFRS; we don't foresee insurmountable challenges to our members becoming fully proficient in the esoteric of the IFRS for SMEs. We envisage our members, while applying the IFRS for SMEs, will encounter situations where the answer is found only in the full IFRS and expect that members will become increasingly versed, through training and practice, in the full IFRS.

Thus, if the IFRS for SMEs is not a completely stand-alone product, this will be mitigated by the fact that a Canadian accountant will be concurrently and increasingly knowledgeable/experienced in the full IFRS as well.

During our roundtable discussion meetings, some wished to have a stand-alone complete document but they were also cognizant of the fact that the document would become bulky. Therefore, they suggested that the standards applicable to infrequent transactions should be included in the appendix for such reasons as disinterest in having something like IAS 39 included completely in the IFRS for SMEs. Some SMEs may never need to refer to such a standard.

On the other hand, some felt that cross-referencing makes sense because if an entity encounters a transaction that it normally would not enter into; it can refer to the full IFRS for guidance. What that means is that the accountant would need to purchase both the full IFRS and the IFRS for SMEs.

If the IFRS for SMEs, as a stand-alone product, is perceived to be expensive, then the users (buyers) of the product should reasonably expect it be completely stand-alone with no cross-references to the full IFRSs. In the end, this issue appears to be more of a cost and convenience issue than one of knowledge or substance.

Thus, we believe that in an age of electronics, both standards can be fully linked electronically and the information can be made readily available. In the current world of technology and communications, the number of pages becomes much less relevant. Recognizing that all nations do not benefit equally from advances in telecommunications, some countries will of course be disadvantaged and will prefer printed versions. Here again, the cost to purchase the standards will likely constitute the major issue.

We would recommend that the IASB price access to its standards by taking into consideration the means of an accountant providing services in some remote part of a lesser developed country. We would recommend also that electronic medium pricing be incremental regardless of the publishing option elected by the IASB.

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.

In our roundtable discussion meetings, the participants discussed the topics identified in paragraphs BC70 – BC93 of the Basis for Conclusions (Financial instruments, Goodwill impairment, Treat all research and development costs as expense, Cost method for associates and joint ventures, Income taxes – “timing differences plus” approach, Less fair value for agriculture, Employee benefits – defined benefit plans, Share-based payment, Leases, and Transition to the IFRS for SMEs) and generally agreed with the simplifications of recognition and measurement principles proposed by the Exposure Draft.

We would however table some additional comments.

Goodwill impairment

We support the view that an entity should look for indicators of impairment rather than perform impairment valuation every year. Importantly, we should recognize that, in Canada, the banks and other lending institutions do not lend money outright against goodwill.

Cost method for associates and joint venture

We support the view that the cost method for accounting for investments in associates and joint venture should be permitted under the IFRS for SMEs. We would like to add here that all inter-company transactions be performed at fair value.

Less fair value for agriculture

We agree with paragraph 35.1.(b) but have difficulty rendering the term “readily determinable without undue cost or effort” operational. While one can grasp the spirit of its meaning, we ask for the definition of this term under our section “Other minor observations” at the end of this response.

Employee benefits – defined benefit plans

During our discussions, several participants expressed the view that in Canada, generally SMEs do not offer defined benefit plans therefore they suggested that the IFRS for SMEs should only discuss accounting for defined contribution plans. However, some SMEs do offer an Individual Pension Plan (IPP) which is briefly described below:

Individual Pension Plan is best suited for business-owners and incorporated professionals and senior executives who work for incorporated businesses. Plan contributions are made by the employer. The contribution amount is computed actuarially and depends on the age of the member and his or her reported salary history (in Canada - T4 reported earnings). Under the federal and provincial regulations, an IPP is considered to be a defined benefit plan. Thus, if the market drops, additional tax-deferred contributions can be made to make up the shortfall. There are several other technical issues however what we wish to point out is that an IPP is considered as a defined benefit plan. Thus, the SMEs liability should be reported based upon Section 27 Employee Benefits of the Exposure Draft.

Consequently, we support the inclusion of a defined benefit section in the IFRS for SMEs.

We, however, have an issue with the “short-term employee benefits” part of the Section in the full IFRS and, accordingly, with the same part of the Section in the IFRS for SMEs. The Exposure Draft defines “short-term employee benefits” as wages, salaries and social security contributions. In Canada, we are sure, most CGA members and the public at large would not consider salary and wages as employee benefits; they would consider them as a “right of compensation” for performance of “work”. They are not paid as a grace or the generosity of the employer. Therefore, we would recommend elimination of salary and wages from the definition of short-term employee benefits. We presume the same sentiment would be prevalent in other countries as well. The ED mentions social security contributions also as short-term benefits. In Canada, most social security contributions are legislated (e.g. Canada Pensions Plan) and employers and employees contribute their share to state-run programs, if applicable, respectively. Few in Canada would consider the employer contribution as a short-term benefit afforded by SMEs; they are part of the total compensation to an employee for work performed. The amounts contributed by the employer should be accounted for as legislated contributions; not short-term employee benefits. We are taking exception to the wording only.

Current Canadian standards permit the “corridor approach” for smoothing the amounts as does the full IFRS. In the ED, favour is afforded to recognizing actuarial gains and

losses in full in profit and loss because this is the simpler option. We agree because it also provides more transparency; whereas smoothing doesn't².

The ED expresses use of the projected unit credit method. We agree, but would also suggest that other actuarial method(s) should be acceptable where an alternate method is more appropriate under the circumstance and is recommended by the actuarial society of that jurisdiction.

Share-based payment

Paragraph BC91 of the Basis for Conclusions states that if an entity is unable to estimate reliably the fair value of the equity instrument granted at the measurement date it should measure the instrument at its intrinsic value. Paragraph 25.4 of the ED states the intrinsic value "... is the difference between the fair value of the shares and the price...". Thus determination of the fair value is required. This appears to be circular.

Also, paragraph BC91 of the Basis for Conclusions introduces another terminology "estimate reliably the fair value". We have difficulty in making this term operational and ask for the definition of this term under our section "Other minor observations" at the end of this response.

Other issues

The Exposure Draft asks for other events and conditions that might require recognition and measurement simplifications. As mentioned in our general remarks, SMEs come in various sizes and command different reporting needs. Other topics that might need further examination with respect to recognition and measurement simplifications are Segment reporting, Earnings per share, and Interim report.

We are of the view that SMEs should not be required to provide information on Segment reporting, Earnings per share, and Interim report. If they need to provide such information for competitive purposes, they should refer to the full IFRS.

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.

² "Addressing the Pensions Dilemma in Canada", 2004, Rock Lefebvre and Amar Goomar, Certified General Accountants Association of Canada; accessible on CGA website.

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

During our roundtable discussions, participants discussed the topics identified in paragraphs BC94 – BC107 of the Basis for Conclusions (Not to require a cash flow statement, Treat all leases as operating leases, Treat all employee benefits as defined contribution plans, Completed contract method for long-term contracts, Fewer provisions, Non-recognition of share-based payment, Non-recognition of deferred taxes, Cost model for all agriculture, No consolidated financial statements, and Recognition of foreign exchange gains and losses and revaluation increases in profit or loss) and generally agreed with the IASB's judgment to not adopt the recognition and measurement simplifications.

We however provide the following supplemental comments.

Not to require a cash flow statement

Please refer to our comments under Question # 4.

Treat all employee benefit plans as defined contribution plans

Please refer to our comments under Question # 2.

Non-recognition of deferred taxes

During our roundtable discussions much time was devoted to the merits and cost/benefit of deferred tax reporting by small enterprises/entities. One segment of the accounting community favours the taxes payable approach. The proponents consistently cite the cost/benefit relationship, and specifically, the limited usefulness of deferred tax recognition. Another segment of the accounting community favours recognition of deferred taxes with proponents arguing that, generally, deferred tax is a liability and should be reported as such. Ignoring it is simply considered by some as tantamount to endorsing off balance sheet items. Taken this way, it goes against transparency and general public interest. Interestingly, discussion is often pursued in the form of anecdotal debate or through the construction of scenarios. What is probably most obvious is that the experience and preference of practitioners departs from theoretic reasoning or academic justification. Observers did however highlight that a solution to the dilemma might best be arrived at by agreeing on the definition of primary and secondary users. Naturally, the more restricted the definition of user (current or prospective), the more contracted becomes the argument for the deferred taxes approach.

Through careful analysis of various scenarios, CGA-Canada provisionally supports the view of the Exposure Draft that deferred taxes be reported by all enterprises in so far as and subject to corroborating or contradictory evidence emanating from the results of the field tests that are being organized by the IASB.

No consolidated financial statements

In Canada, for tax and estate planning purposes, an SME may be organized into two or more legal entities but, in fact, those entities may operate as a single economic entity. Those legal entities may be owned by the same shareholders/owners as well.

One segment of the accounting community strongly favours consolidation because the users of the financial statements (see discussion on GPFS) find information of the economic entity more useful than the information pertaining to the legal entities because these entities often enter into transactions with each other. Such transactions may not be structured or priced at arms length basis. The entities are jointly managed and loans are cross-collateralised. Therefore, this segment of the community supports that the financial statements must reflect the financial position, operating results, and the cash flow of the economic entity; not the individual legal entities. This community cites that, presently, the Differential Reporting (DR) prescribed in Canada provides exemption, i.e. not to consolidate if agreed to by all shareholders as a major problem because operating company and holding company owners can manipulate results. It is believed by these proponents that through consolidated results, the generic users are better served.

An opposing view of the accounting community is that a majority of SMEs do not have sophisticated accounting departments and consequently rely on external accountants to prepare the year end financial statements. Owners want to know how each company (or component) of their business has performed and do not appreciate any necessity to aggregate (i.e. consolidate). As clients, they wish to minimize additional fees for GAAP level services that they do not welcome or require. This community cites that current Differential Reporting (DR) as prescribed in Canada provides exemption; i.e. not to consolidate if agreed to by all shareholders.

Through careful analysis of various scenarios, we provisionally support the views expressed by the Exposure Draft in that the users of financial statements are advantaged to know the results of the economic entity. That is, to the extent that the results of the IASB field testing may or may not bear that out.

Other issues

The Exposure Draft asks whether the Board should reconsider any of the above recognition and measurement simplifications. We note that there are a few situations and circumstances where further recognition and measurement simplification might be

better served such as Component depreciation and Projected unit credit method (discussed under Question # 2 Employee benefits).

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?

Roundtable participants discussed the topics identified in paragraphs BC108 – BC115 of the Basis for Conclusions (Investment property; Property, plant and equipment; Intangible assets; Borrowing cost; Presenting operating cash flows; and Accounting for government grants) and generally agreed that 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.

We would however provide some additional comments as follows.

Borrowing cost

Please refer to our comments under Question # 5.

Presenting operating cash flows

CGAs are trained in both the direct and the indirect method of presenting cash flows from operations.

The indirect method is favoured by some accountants and practitioners because they believe it provides insight into the accrual accounting and they have seen it favoured by banks and other lending institutions.

Chartered Financial Analysts' (CFA) Institute in its July 2007 release of A Comprehensive Business Reporting Model outlined 12 principles. Principle # 9 states that the indirect cash flow statements of most companies do not provide information that is most relevant to investors. It also states that only a handful of the thousands of public companies worldwide report cash flows using the direct method.

The Institute states that the indirect method does not provide a clear picture of the company's current means of generating cash flows, the individual patterns of inflows and outflows resulting from transactions and events, and the company's effectiveness in producing cash.

If we are to accept this reasoning, when using the indirect method, we wonder how the broad user populace makes investment decisions on this information when sophisticated investors and financial pundits have difficulty finding usefulness of information for analyses of public companies not using the direct method. It would be curious to assess how a new investor makes the investment decision to enter into partnership (minority interest) in a non-publicly accountable enterprise in the absence of an expert who can distil the information.

Perhaps, the Board could reconsider the recommendation in IFRS for SMEs or commission research on how best to define minority shareholder interests in a non-publicly accountable enterprise.

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?

We agree with the option to allow SMEs to choose either the expense model or the capitalization model for borrowing costs.

The expensing of borrowing costs is transparent vis-à-vis interest expense; whereas, if capitalized, one needs to do a little extra work to determine what the interest expense

amount is. As the IAS 23 Exposure Draft proposes that the capitalization model is appropriate for publicly accountable enterprises and large SMEs whereas, we believe, that expensing is most suitable to smaller SMEs including micro-entities.

The expensing model, if chosen, should be applied to all borrowings including inventory items being constructed in-house with borrowed funds. Similarly, if the capitalization model is elected, it should apply to all borrowings.

The capitalization model, if elected, although not prescribed in the IFRS for SMEs, would permit an entity to move from a non-publicly to a publicly accountable entity. Also, under the capitalization model, an entity could be permitted to choose either the specific element borrowing cost or average cost of borrowing, whichever is cost-effective.

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?

Roundtable participants discussed the topics identified in paragraphs BC57 – BC65 of the Basis for Conclusions (Hyperinflation, Equity-settled share-based payment, Agriculture, Interim financial reporting, Lessor accounting for finance leases, Earnings per share, Segment reporting, and Insurance) and generally agreed that typical SMEs are not likely to encounter such transactions or conditions.

We would also like to see added to the list “Extractive industries”, as a typical SME would likely be a listed company. For your information, under General Remarks, we have already mentioned that on TSX Venture Exchange, there are several listed companies that have assets of less than \$400,000 and some of them belong to “Extractive industries”.

The topic “Insurance” should be deleted from the list as it has been scoped out of the entities eligible for IFRS for SMEs (See paragraph BC35 of the Basis for Conclusions).

We found the summary related to “Hyperinflation” useful as it serves a refresher of the full IFRS; therefore we propose that you provide a summary of each of the transactions or conditions that a typical SME is not likely to encounter.

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?

We agree with the requirements of paragraphs 10.2 – 10.4, coupled with the explicit cross-references to particular IFRSs in specific circumstances.

In our consultations, participants discussed some debt instrument/conditions such as puttable shares, subordinated debt, convertible debt, retractable debt, etc. The general agreement was that a typical SME would not encounter such transactions, however, if one does encounter such instruments; they should be free to follow the provisions of paragraph 10.2 – 10.4, coupled with the explicit cross-references to particular IFRSs in specific circumstances.

There is however a particular instrument in Canada referred to as “**high/low**” **redeemable preferred shares** that require some elaboration because the guideline afforded by paragraphs 10.2 – 10.4 might not suffice:

In Canada, “high/low” redeemable preferred shares are commonly issued in estate freeze arrangements in private companies. The owners of the private companies enter into such arrangements purely for tax motivated purposes. Therefore, the EIC – 69 (Emerging Issues Committee which is equivalent to IASB’s IFRIC) discussed the application and arrived at a consensus position that these shares constitute financial liabilities when they are mandatory redeemable for cash or other financial assets on demand by the holder. Similar to a demand note, the issuer of high/low shares would measure its liability based on the redemption amount of the shares. The holder’s intention to redeem or not, or the inability of the issuer to satisfy the call if so requested is substantively irrelevant.

With the introduction of Section 3860 (which is similar to IAS 39) on January 1, 1996, an article in CA Magazine (November 1996) in Canada³ discussed the issue which had earlier been discussed in EIC – 69 and its applicability within Section 3860. This Section states that the issuer of a financial instrument should classify it as a liability or equity in

³ “Liability or equity?”, Peter Martin CA, CA Magazine November, 1996.

accordance with the substance of the contractual arrangement. This statement applies to all types of instruments whether they are traditional or innovative. In fact, this statement applies to everything an accountant encounters professionally.

At that time, the article stated that the industry raised two concerns: 1. they do not agree that the result best reflect the substance of the obligation, and 2. the new standards create adverse consequences for some businesses. The author goes on to state that in the judgement of the standards-setter "... it is better to present high/low shares as liabilities" because that is what the substance of the transaction is.

Interestingly though, it should be noted that tax authorities in Canada consider these shares to be equity.

At least in part prompted by tax treatment, on September 1, 2007, the AcSB withdrew the EIC - 69 and subsequently, changed the accounting standards effective October 2007, to conform to the stipulated tax treatment. It is an unfortunate situation where tax treatment is driving the accounting for the transaction and the standards-setter is ill-pressed to adversely circumvent the tax provision. In so doing, the substance of the transaction can be marginalized.

Paragraph BC30 of the Basis for Conclusions in IFRS for SMEs states that tax authorities often look to financial statements as the starting point for determining taxable income. Therefore, profit or loss determined in conformity with the proposed IFRS for SMEs can serve as the starting point for determining taxable income in a given jurisdiction by means of a reconciliation that is easily developed at a national level.

CGA-Canada supports this view rather than the implicit approach inherent to the Canadian approach that the profit and loss be determined using the tax base and then reconciled in the notes, if necessary, with the IFRS for SMEs. In so doing; the main advantage of being able to compare like entities in different jurisdictions is tainted.

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?

Given the embryonic stage of IFRS adoption or harmonization in Canada, Canadian accountants generally do not possess extensive hands-on experience in the use and

application of the full IFRS. While exceptions are of course present, the domestic industry; particularly those serving the SME sector, are largely preoccupied at this time with orientation to IFRS. As Canada collectively gains its experience, it will be better poised to articulate its necessitated guidance at a future time. .

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?

Consistent with CGA-Canada sentiment to Question # 8 above, we contend that it may be premature to deliberately pronounce the adequacy of envisioned disclosures.

Nevertheless, we discussed whether the discussion on functional currency is warranted given that the perceived profile of the typical SME operating in a particular jurisdiction would be the subject only of domestic operations. That said, there may be a significant number of SMEs that may have operations in other jurisdictions and for those SMEs, the discussion may well be warranted should the numbers justify.

On balance, we feel that this topic should be left for reference to the full IFRS; i.e. should a SME have foreign operations, it should refer to full IFRSs.

Other items/situations/circumstances that should be disclosed include bank indebtedness, credit line(s) information, loan commitment(s), share commitment(s), drawdown(s), etc. in so far however that such disclosure not unreasonably confer competitive disadvantage.

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?

Consistent with the views espoused in the response to Question # 8.

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?

During our discussions, some participants expressed that a two-year frequency would be welcome relief from the current practice in Canada. Some members believed that a regular release every two year period could be followed by a big announcement to draw attention to the need for accountants to take heed.

Others expressed that the amendments to IFRS for SMEs should be made as and when a change is made to full IFRSs. Otherwise the IFRS for SMEs would not stay in-step with the full IFRSs.

On balance, CGA-Canada supports a decision to publish IFRS for SMEs approximately every other year.

We would however propose that the IASB consider publishing IFRS for SMEs, in the beginning, on an annual update basis for say, the first three years. Thereafter, when issues have stabilised, issuance on a two-year basis is expected to be adequate.

Other minor observations

- **Definition of terms “readily determinable without undue cost or effort” vs. “fair value cannot otherwise be measured reliably”**

The Exposure Draft advanced the concept of “readily determinable without undue cost or effort” while discussing fair value under Section 35 Specialised Industries without supplemental definition. On its face, it appears simple enough but it will likely be difficult to put into operation with common purpose and uniform application. In

group discussions, we did discuss other related concepts such as readily available vs. readily determinable, impracticable (i.e. one has made reasonable effort), etc. We would ask that the IASB provide explicit definitions of such concepts in order to harmonize understanding and application. Also, should the term “readily determinable without undue cost or effort” not apply to financial instruments when valuing non-traded securities? Section 11 Financial Assets and Financial Liabilities, paragraph 11.7(c) talks about “whose fair value cannot otherwise be measured reliably”. Should the concept “readily determinable without undue cost or effort” and “whose fair value cannot otherwise be measured reliably” be used interchangeably?

- Right bracket “)” is missing in last line of Section 19.1(e).
- Section 30.1, last line reads “... Section 11 Financial Instruments.” It should read “... Section 11 Financial Assets and Financial Liabilities.”
- Paragraphs BC71 – BC78 of the Basis for Conclusions are categorised as Financial instruments. They should be categorized as Financial Assets and Financial Liabilities. Or a statement should be made that both terms have been used interchangeably.
- Add terms in Glossary such as “inside basis differences” – see Section 28.11(a); “outside basis differences” – see Section 28.11(b); “convenience translation” – see Section 30.29; etc.

Conclusion

Because of the globalization of the marketplace and the concomitant desire for some uniformity and comparability, the application of IFRS for SMEs can help in decision making. In mergers and acquisition activities within a jurisdiction or on an international basis - - in seeking to lower the cost of capital - - in participating in multi-jurisdictional supply chains - - in bolstering comparability of financial statements by investors residing in different jurisdictions, etc., IFRS for SMEs can be of significant value. While not the object of this comment paper, the provision of IFRS for SMEs can intuitively facilitate moving down from full IFRS to IFRS for SMEs or moving up from IFRS for SMEs to full IFRS; etc. This may have some appeal for some.

While the matter will be further analysed and deliberated domestically and abroad, CGA-Canada continues to be supportive of the IFRS for SME initiative and recommends that the General Purpose Financial Statements prepared in accordance with the eventual English language version of IFRS for SMEs as published by the IASB, without modification, be adopted by Canada.

In closing, we congratulate the IASB on its progress and look forward to the results of the field testing and any consequential rethinking of IFRS for SMEs. CGA-Canada also

welcomes future exchanges and encourages the IASB to correspond with Amar Goomar at agoomar@cga-canada.org or Rock Lefebvre at rlefebvre@cga-canada.org should further elaboration be desired.

Sincerely,

[Original signed by:]

Anthony Ariganello, CPA (Delaware), FCGA
President and CEO