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**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

## **INFORMATION FOR OBSERVERS**

**Board Meeting:** 21 June 2006, London  
**Project:** Accounting Standards for Small and Medium-sized Entities  
(Agenda Paper 4)

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1. Agenda Paper 4 is the staff memo identifying issues for discussion relating to the following two documents, which are attachments to Agenda Paper 4<sup>1</sup>:
  - a. Attachment A is a marked version of the revised draft Exposure Draft *International Financial Reporting Standard for Small and Medium-sized Entities* [‘June 2006 draft ED’]. It reflects all changes since the version discussed at the May 2006 Board meeting.
  - b. Attachment B is a clean version of the revised draft ED.
2. Agenda Paper 4 identifies a number of specific issues for Board discussion in June 2006. These are presented enclosed in a “box”.

### **What's New?**

3. In the June 2006 draft ED:
  - a. All decisions from the May meeting are reflected, as are most comments and editorial suggestions provided via written drafts from Board members and several members of the Working Group.
  - b. The glossary is incorporated and updated
  - c. Completely new model financial statements and notes are included in Section 9.
  - d. Section 12 on financial instruments has been substantially redrafted.
  - e. SPEs have been added to Section 10 (paragraph 10.3).
  - f. Section 39 on first-time adoption has been added.

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<sup>1</sup> Attachments not provided to observers.

## What's Left to Draft?

4. Unfortunately, there were only ten days available following the May meeting for staff to prepare the Board materials for June. Consequently, staff concentrated on the items noted in the preceding paragraph. Staff was not able to move the disclosures into a separate disclosure section or to draft the invitation to comment or basis for conclusions. Also the financial instruments disclosures in Section 12 await decisions on the accounting.

## PREFACE AND SECTION 1 SCOPE

5. At its meeting in May 2006 the Board decided:

**Definition of an SME.** The definition will be amended so that an entity that is a public utility or similar entity that provides an essential public service would not be considered publicly accountable by definition.

6. This has been done – see paragraph 1.2.

### Additional issue – possible deletion of “economically significant” criterion

7. On 29 May 2006, staff participated in an all-day meeting with the EFRAG-FEE SME working group. Views of the EFRAG-FEE working group members on the Exposure Draft were generally favourable. A few issues did arise. One was that the third condition for public accountability in Paragraph 1.2(c) should be left for local jurisdictions to decide. The consensus view was that the following condition should be deleted:
  - (c) it is economically significant in its home country on the basis of criteria such as total assets, total income, number of employees, degree of market dominance, and nature and extent of external borrowings.
8. Staff noted that this had been discussed by the Board in May and that it is the Board's view that an entity that is economically significant in its home country is publicly accountable to the community in which it operates. The external stakeholders in this case do not necessarily have an investor or creditor relationship with the entity. However, they do have a financial interest because their jobs, their businesses and the local economy may depend directly on the entity's financial performance and financial stability. Guidance on the specific criteria for assessing economic significance in an individual national jurisdiction would be left to the regulatory authorities or standard-setters in that jurisdiction – based on the suggested broad criteria in paragraph 1.2.
9. The EFRAG-FEE working group acknowledged this point but, nonetheless, concluded that this should be decided by the jurisdiction rather than required by definition in the IFRS for SMEs. Staff agreed to report the view of the EFRAG-FEE group to the Board.

**Issue: Does the Board continue to believe that an entity that is economically significant in its home country is publicly accountable by definition and, therefore, IAS 1.2(c) should remain?**

### Additional issue – maintaining the IFRS for SMEs

10. Staff proposes to add the following paragraph 17 to the preface:

## **Maintaining the IFRS for SMEs**

17. In each Exposure Draft of a new IFRS or an amendment to an existing IFRS, the Board will indicate how, if at all, it would propose to amend the IFRS for SMEs with respect to the proposals in that Exposure Draft. Comments will be invited. The Board will consider those comments and make tentative decisions regarding the IFRS for SMEs. Approximately every other year, the Board will publish an “omnibus” Exposure Draft of proposed amendments to the IFRS for SMEs based on its tentative decisions. After consideration of the responses to that “omnibus” Exposure Draft, the IFRS for SMEs will be amended.

<b>Does the Board concur with the staff recommendation to add the foregoing paragraph 17 to the Preface?</b>
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## **SECTION 2 CONCEPTS AND PERVASIVE PRINCIPLES**

11. At its meeting in May 2006 the Board decided:

**Pervasive measurement principles.** The draft Exposure Draft included some pervasive principles for recognising assets, liabilities, income, and expenses, based on the IASB Framework, and also some newly developed pervasive measurement principles not in the Framework. The pervasive measurement principles will be deleted.

12. The word “deleted” in the last sentence of the foregoing decision report is not accurate; “modified” is correct. Based on its formal votes on specific paragraphs in the May 2006 draft ED, the Board really decided to delete the notion of matching and to modify, rather than delete, the pervasive measurement principles (see paragraphs 2.41 to 2.50). Those things have been done.

### **Additional issue – are paragraphs 2.15-2.17 needed?**

13. Staff believes that paragraphs 2.18 to 2.31 provide appropriate and adequate guidance regarding the elements of financial statements, and that paragraphs 2.15 to 2.17 are commentary that is not needed in the IFRS for SMEs. Staff, therefore, proposes that 2.15 to 2.17 be deleted (with slight consequential editing of 2.18).

<b>Does the Board concur with the staff recommendation to delete 2.15 to 2.17.</b>
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## **SECTION 3 GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION**

14. At its meeting in May 2006 the Board decided:

**Fair presentation override.** The Board concluded that paragraphs 13-22 of IAS 1 should be included in the IFRS for SMEs. Those paragraphs provide guidance when the relevant regulatory framework requires or prohibits departures from IFRSs to achieve a fair presentation.

15. This has been done (see paragraphs 3.15 to 3.20).  
16. At its meeting in May 2006 the Board decided:

**Current exposure drafts.** Conclusions in current exposure drafts of other standards should not be reflected in the SME Exposure Draft but, if different from the SME Exposure Draft, should be noted in a footnote.

17. The greatest impact of this decision was to undo the many changes that were reflected in the May 2006 draft based on the current Exposure Draft of Amendments to IAS 1. Accordingly, changes have been made in the June 2006 draft ED in Section 3 (especially what constitutes a complete set of financial statements) and in many other places (especially titles of financial statements). The June 2006 draft SME ED has footnote references to the IAS 1 proposed amendments, puttable shares project, and IAS 23 proposed amendments. The Board's May 2006 decision has been implemented with one exception (see next issue).

#### **Additional Issue – opening balance sheet**

18. Paragraph 3.10(a) proposes to require a balance sheet as at the beginning of the period as part of a complete set of financial statements. This is not a requirement currently in IAS 1. Staff proposes this provision because staff believes this is useful information to understand the financial statements of an SME.
- A balance sheet as at the beginning of the period provides a basis for investors and creditors to evaluate information about the entity's performance during the period.
  - The calculation of ratios that analysts often use requires information about the entity from the beginning and the end of the period.
  - Moreover, since the Board noted that the beginning balance sheet is essential to the preparation of the other financial statements that form part of a complete set of financial statements, namely the statements of income, changes in equity, and cash flows.

Therefore, the presentation of an opening balance sheet involves no additional cost for SME preparers.

**Issue: Does the Board concur with the staff recommendation to retain paragraph 3.10(a) and, thereby, to require an opening balance sheet? If yes, staff will add an opening balance into the model financial statements in Section 9.**

## **SECTION 6 STATEMENT OF CHANGES IN EQUITY AND STATEMENT OF INCOME AND RETAINED EARNINGS**

19. At its meeting in May 2006 the Board decided:

**Combined statement of income and retained earnings.** Previously, the Board had concluded that if the only changes to an SME's equity during a period arise from profit and loss and payment of dividends, the SME may present a statement of income and retained earnings instead of separate income and equity statements. The Board clarified that an SME is eligible to present a combined statement of income and retained earnings if its equity changes as a consequence of (a) correction of a prior period error or (b) changes in accounting policy, in addition to changes as a consequence of profit and loss and dividends.

The Board also decided that the Section on the statement of income and retained earnings should be combined with the section on the equity statement.

20. The foregoing have been done (see paragraph 6.6).

## **SECTION 8 NOTES TO THE FINANCIAL STATEMENTS**

### **Additional issue – disclosure of distributable income**

21. At its meeting in May 2006 the Board decided to require disclosure of the amount of “distributable income”. Staff neglected to reflect this in the June 2006 draft ED and in the model financial statements. Staff proposes to add the following paragraph:

8.9 An entity shall disclose the amount of its retained earnings that is legally available for distribution to shareholders as a dividend.

<b>Issue: Does the Board concur with the foregoing addition recommended by the staff?</b>
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### **Additional issue – deletion of disclosure about capital management objectives**

22. Paragraph 8.8 requires:

8.8 An entity shall disclose in the notes information about the entity’s objectives, policies, and processes for managing capital. That information shall include:

- (a) a description of what the entity manages as capital and its objectives and policies for doing so;
- (b) if the entity is subject to externally imposed capital requirements, the nature of those requirements and how they are managed, including whether the requirements have been complied with.

23. Staff believes that the disclosure required by paragraph 8.8(a) is not cost-beneficial for an SME. Many SMEs are unlikely even to have objectives, policies, and processes for managing capital. Staff proposes that 8.8(a) be deleted.

<b>Issue: Does the Board concur with the staff recommendation to delete 8.8(a)?</b>
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## **SECTION 9 MODEL FINANCIAL STATEMENTS**

24. As noted earlier, these are entirely new. Depending on the Board’s decision on paragraph 3.10(a), an opening balance sheet may need to be added. Capital disclosures may also need to be added. Staff welcomes editorial suggestions of Board members “off line” on the model financial statements.

<b>Issue: Overall, what are Board members’ reactions and views concerning the model financial statements for SMEs?</b>
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## **SECTION 10 CONSOLIDATED FINANCIAL STATEMENTS**

25. At its meeting in May 2006 the Board decided:

**Combined financial statements.** A description of these should be added. It should be made clear that if an entity chooses to present combined financial statements, it must comply in full with the IFRS for SMEs.

26. This has been done (see paragraphs 10.11 and 10.12).

## **SECTION 11 ACCOUNTING POLICIES, ESTIMATES, AND ERRORS**

27. Paragraph 11.11 provides:

11.11 When an entity has not applied an amendment to this Standard that has been issued but is not yet effective, the entity shall disclose:

- (a) this fact; and
- (b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Standard or Interpretation will have on the entity's financial statements in the period of initial application. [IAS 8.30]

28. Staff believes that this requirement, while appropriate in the context of a publicly accountable entity, is not necessary for an SME, and is burdensome. Staff recommends that 11.11 be deleted.

**Issue: Does the Board concur with staff's recommendation to delete paragraph 11.11?**

## **SECTION 12 FINANCIAL ASSETS AND FINANCIAL LIABILITIES**

29. At its meeting in May 2006 the Board decided:

**Financial instruments.** The section of the draft Exposure Draft covering financial instruments had not previously been discussed by the Board. The Board made numerous changes to this section, including:

- The IFRS for SMEs should require a financial asset to be measured at fair value through profit and loss when its fair value is readily obtainable or it is a derivative.
- Some guidance on fair value should be added to the draft ED, with a cross-reference to the more detailed guidance in IAS 39 Financial Instruments: Recognition and Measurement.
- Initial measurement of financial instruments is at fair value, consistent with IAS 39. Hedge accounting guidance should be included by cross-reference to IAS 39.
- The Board tentatively decided that the fair value option applicable to SMEs should be unrestricted. The Board noted that it has restricted the fair value option in IAS 39 in response to concerns of bank regulators, which are not applicable to SMEs.

Staff will revise this section with the counsel of two Board members.

30. Section 12 on financial instruments has been mostly rewritten, based on the very substantial Board comments on the first draft in May, and with considerable post-meeting help from the two Board members. Because the two Board members hold some differing views on whether and how IAS 39

can be simplified for SMEs, Section 12 reflects some positions that one or the other of the Board members may not support. Several such points will be noted below. Responsibility for Section 12 as written is the staff's.

31. The revised draft offers proposals for simplification of IAS 39 for SMEs in three important areas:
- Classification of financial instruments
  - Derecognition
  - Limited relief from hedge accounting focussed on the two kinds of hedging that an SME is likely to do.

### **Classification of financial instruments**

32. There are two classifications – fair value through P&L and cost/amortised cost – that apply to both financial assets and financial liabilities. Fair value through P&L is now the default classification for all financial assets and financial liabilities. An entity may elect to use cost/amortised cost for three types of financial instruments. An important benefit of this approach is that it avoids having to define a derivative or an embedded derivative. No fair value changes are recognised in equity. Intent-driven classification (eg held to maturity) is eliminated. A concession from IAS 39 is that amortised cost could conceivably be elected for a traded instrument, but this is not likely to be common for an SME.

### **Derecognition**

33. The draft imposes a high hurdle for derecognition – only when substantially all risks and rewards have been transferred. The big benefit is that an SME will not have to refer to the complex derecognition provisions of IAS 39. A drawback would be that the SME standard would not derecognise securitisations whereas IAS 39 would; however SMEs are not likely to engage in securitisation transactions anyway, and they always have the option of following full IFRSs if they wish.
34. One of the advisory Board members questions the word “significant” in 12.26(b):
- 12.26 An entity shall derecognise a financial asset when, and only when:
- (a) the contractual rights to the cash flows from the financial asset expire or are settled; or
  - (b) it transfers to another party all of the significant risks and rewards relating to the financial asset.
35. Staff believes the word “significant” is consistent with IAS 39 and is necessary because often some risks are retained under the law (eg, risk of not having had good title). Staff believes that the condition in 12.26 is already more strict than IAS 39, but the benefit for an SME is that (a) it is simple and (b) it avoids requiring a fallback to the derecognition provisions of IAS 39. Staff proposes no change to 12.26.

<b>Issue: Does the Board concur with the staff recommendation to keep “significant” in paragraph 12.26?</b>
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### **Limited relief from hedge accounting**

36. Basically Section 12 says follow the hedge accounting provisions of IAS 39. However, it tries to address and simplify a bit the two kinds of hedges an SME is likely to enter into:

#### **Cash flow hedge of foreign currency risk**

37. The relief granted is that if, at inception, the SME hedges 100% of its FX risk (not a portion) and the hedge was expected to be highly effective, then the 80%-125% retrospective test for actual high effectiveness does not apply. However, of course, all actual ineffectiveness must be recognised in profit or loss whether within or outside the 80-125% range.
38. One of the advisory Board Members questioned why staff has proposed to omit the 80% to 125% test. The reason is that for a cash flow hedge it does not seem to add much discipline. If the 80%-125% test is retained, then if an entity is outside the range, it must discontinue hedge accounting prospectively. Or it rebalances the hedge so it is within the range. The problem for an SME is that the entity may not know it is outside the range at a particular date, eg the middle of the month, because it measures only at the end of the month. The result is that from the middle of the month to the end of the month both the effective portion and the ineffective portion of the hedge is recognised in income. A large entity can more easily monitor a hedge on a daily basis to avoid this problem than can an SME. The approach in the draft SME ED recognises the ineffective portion but allows the effective portion to continue to be accounted for using fair value hedge accounting. Also the change in value of the hedging instrument is fully transparent in equity (which is what IAS 39 requires).
39. One of the advisory Board Members noted that another way to address this burden on SMEs is to require the 80%-125% test only quarterly for SMEs, whereas it is required on an ongoing basis under IAS 39.

#### **Fair value hedge of interest rate risk**

40. The relief granted would apply only when an entity hedges the interest rate risk in a debt instrument that is measured at amortised cost. (Note that the classification requirements, especially paragraph 12.6, restrict this category). The hedging instrument is either a swap or purchased cap or floor. Any change in fair value of the hedging instrument is reported in equity and amortised through profit and loss when the future interest rate payments are made. In effect, this approach assumes no ineffectiveness, but disclosure will be required of the amounts reported in equity and amortisations thereof.
41. One of the advisory Board Members questioned why the change in fair value of the hedging instrument in a fair value hedge of interest rate risk should be reported in equity by SMEs whereas it is reported in profit or loss under IAS 39. Staff has proposed this method because it allows an SME to qualify for hedge accounting in one narrow circumstance without having to read IAS 39 and determine what is a derivative, what qualifies as a hedged item and hedging instrument, and how to measure and assess effectiveness. The special SME fair value hedge accounting is permitted only for a specific asset designation ("a debt instrument measured at amortised cost") and only using limited number of financial instruments. Since qualification is not based on intent; therefore held to maturity is not a consideration here (the SME standard



does not have an intent-driven amortised cost financial asset). Special SME fair value hedge accounting is not allowed for portfolios (only for “a debt instrument measured at amortised cost”) so it does not introduce a method that ignores prepayments. Staff believes that it provides a simplified method for demonstrating compliance. Staff acknowledges that the trade off is that it requires the effect of the hedging activity to be reported, fully transparently, in equity.

**Issue: Does the Board concur with Section 12 as proposed by the staff? Staff suggests that the Board consider separately the three simplifications proposed by the staff:**

- **Classification of financial instruments**
- **Derecognition**
- **Limited relief from hedge accounting focussed on the two kinds of hedging that an SME is likely to do.**

**Then consider other issues in Section 12.**

## **SECTION 14 INVESTMENTS IN ASSOCIATES**

42. Staff has added the following sentence at the end of paragraph 14.3:

“If the investor prepares both consolidated financial statements and separate financial statements, it may choose a different model in the consolidated statements and in its separate statements.”

43. This matter was not addressed in the May draft. Staff believes that the proposal is consistent with IAS 28, which allows different accounting for associates in consolidated and separate statements.

**Issue: Do Board members concur with the staff recommendation? [Note that a similar question arises with respect to Section 15 – see paragraph 15.8 of the draft Exposure Draft. The decision here will also be applied in Section 15.]**

44. Paragraph 14.6 provides that if an investor chooses fair value through profit or loss as its accounting policy for associates but is unable to measure reliably the fair value of a particular investment in an associate, then the investor shall use the cost model for that investment. One Board member has questioned why cost is the required alternative? Staff has proposed cost because it is the simpler of the remaining choices (the other being equity method).

**Issue: Do Board members concur with the staff recommendation that the cost method be required in this circumstance? [Note that a similar question arises in Section 15 – see paragraph 15.12 of the draft Exposure Draft. The decision here will also be applied in Section 15.]**

## **SECTION 15 INVESTMENTS IN JOINT VENTURES**

45. The two issues raised with respect to Section 14 also arise with respect to Section 15.

## **SECTION 18 INTANGIBLE ASSETS OTHER THAN GOODWILL**

46. At its meeting in May 2006 the Board decided:
- Development cost.** The draft Exposure Draft will include an option for an SME to charge all development cost to expense. An SME that wishes to capitalise development cost would be directed to the requirements of IAS 38 Intangible Assets.
47. This has been done – see paragraphs 18.12(b) and 18.13.]

## **SECTION 19 BUSINESS COMBINATIONS AND GOODWILL**

48. At its meeting in May 2006 the Board decided:
- Business combinations.** Material on business combinations should be removed from the IFRS for SMEs and, instead, will be addressed by cross-reference to IFRS 3 *Business Combinations*.
49. This has been done – see paragraph 19.5.] However, see next issue.

### **Additional issue – reinstate material on business combinations**

50. One of the points raised at staff's meeting with the EFRAG and FEE SME working group [mentioned earlier in paragraph 7 of this Agenda Paper] is that business combination transactions are common for SMEs. This point also was noted by many respondents to the Board's recognition and measurement questionnaire, in which we asked whether a section in the SME standard on business combinations is needed. The EFRAG-FEE working group believes that the IFRS for SMEs should include a section on business combinations because SMEs commonly have such transactions. Staff's view is that the IFRS for SMEs should be as self-contained as possible for a typical SME with about 50 employees. Since business combination transactions are not rare for such an entity, staff proposes that paragraphs 19.6 to 19.26 from the May draft (approximately four A4 pages) should be reinstated.

**Issue: Does the Board concur with the staff's recommendation to address business combinations in the IFRS for SMEs rather than by cross-reference to IFRS 3?**

## **SECTION 20 RIGHTS AND OBLIGATIONS UNDER LEASES**

### **Additional issue – address finance leases by cross-reference to IAS 17**

51. One Board member has proposed that all discussion of finance leases be removed from the IFRS for SMEs and, instead, finance leases be addressed by cross-reference to IAS 17. Staff acknowledges that many lessors under finance leases will be outside the scope of the IFRS for SMEs, because they are financial institutions, and therefore staff recommends removing lessor accounting under finance leases from the IFRS for SMEs. Essentially, paragraphs 20.16 to 20.21 would be replaced by a cross-reference to IAS 17. However, many typical SMEs with about 50 employees are likely to have entered into a finance lease as a lessee. Since the Board's approach is to include in the IFRS for SMEs standards for transactions typically encountered by an SME with about 50 employees, staff recommends retaining lessee accounting under finance leases in Section 20.

**Issue: Does the Board concur with the staff's recommendations to (a) address lessor accounting under finance leases by cross-reference to IAS 17 and (b) to retain the standards for lessee accounting under finance leases in Section 20?**

## **SECTION 21 PROVISIONS AND CONTINGENCIES**

### **Additional issue – constructive obligations**

52. A Board member has pointed out that the notion of a constructive obligation is used in several of the examples appended to Section 21 and is defined in the glossary, but the principle relating to recognition of constructive obligations is not in Section 21. Staff intends to add the principle in Section 21 and also revise paragraph 2.23 to address clearly the concept of both legal and constructive obligations.

**Issue: Does the Board concur with the staff's recommendation to add discussion of constructive obligations as above?**

53. Paragraph 21.3 states:
- 21.3 An entity shall recognise a provision when, and only when, it is probable (ie more likely than not) that a present obligation exists, as a result of a past event, and that it will require a transfer of economic benefits in settlement in an amount that can be estimated reliably.
54. A Board member disagrees with “exists” (an obligation either exists or it does not, it cannot “probably exist”). Staff recommends changing it to “has arisen”.

**Issue: Does the Board concur with the staff's recommendation?**

## **SECTION 22 EQUITY**

### **Additional issue – receivable for share issuance**

55. A Board member questions paragraph 22.2, which provides that:
- “If the shares are issued before the cash or other resources are provided, the entity shall recognise a corresponding receivable.”
56. That Board member suggests that the receivable should be presented as an offset in equity, rather than as an asset. Staff recommendation is to report the receivable as an asset if it legally enforceable, because the shares have been issued.

**Issue: Does the Board concur that the receivable should be reported as an asset?**

### **Additional issue – changes in noncontrolling interest**

57. Staff calls to the Board's attention that paragraph 22.9 is new and was not in the May 2006 draft.
- 22.9 In consolidated financial statements, equity includes a noncontrolling interest in the net assets of a subsidiary. Changes in a parent's controlling interest in a subsidiary that do not result in a loss of control should be treated as transactions with equity holders in their capacity as equity holders. No gain or loss on these changes shall be recognised

in consolidated profit or loss. Also, no change in the carrying amounts of assets (including goodwill) or liabilities shall be recognised as a result of such transactions.

**Issue: Does the Board concur with paragraph 22.9?**

## SECTION 23 REVENUE

58. Should accounting for interest and dividend income be specified in Section 12 *Financial Assets and Financial Liabilities* rather than in Section 23 *Revenue*? Staff recommends retaining it in Section 23 because that is consistent with the approach under IFRSs.

**Issue: Does the Board concur with keeping standards for interest and dividend income in Section 23?**

## SECTION 24 GOVERNMENT GRANTS

59. At its March 2006 meeting, the Board decided:

**Government grants** An SME would use the principle for recognising grants in IAS 41 *Agriculture* as the basic principle for recognising all grants. However, an SME wishing to use one of the alternatives in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* would be permitted to do so by cross-reference to IAS 20. Under the IAS 41 approach:

- an unconditional grant would be recognised in income when the grant is receivable;
- a conditional grant would be recognised in income when the conditions are met;
- grants would be measured at the fair value of the asset received; and
- grants received before the income recognition criteria are satisfied would be recognised as deferred income (a liability).

60. In retrospect, Section 24 as drafted for the May 2006 Board meeting did not appropriately reflect the foregoing March 2006 decisions, because it applied the IAS 41 approach only to grants related to assets carried at fair value through profit or loss. Consequently, this section has now been redrafted in the June 2006 draft to reflect the March 2006 decisions.

**Issue: Does the Board believe that Section 24 appropriately reflects the Board's decisions?**

## SECTION 29 INCOME TAXES

61. At its meeting in May 2006 the Board decided:

**Income taxes.** The draft Exposure Draft included a requirement that deferred tax assets and liabilities should be recognised for all taxable differences between carrying amounts and tax bases of assets and liabilities (ie the various exceptions and special rules in IAS 12 *Income Taxes* would be eliminated). The Board tentatively decided to give

SMEs the same exceptions as are in IAS 12. The Board also asked the staff to consider whether some of the Board's decisions, to date, in its project to revise IAS 12 should be incorporated into the draft IFRS for SMEs.

62. The exceptions have been added into paragraph 29.4. Further, the definitions of tax expense, temporary difference, taxable temporary difference, and deductible temporary difference in the glossary are now the latest ones in the IAS 12 convergence project draft, rather than those in the 2006 Bound Volume glossary. These do not change substance from the existing IAS 12 but are more easily understood.

## **SECTION 36 SPECIALISED INDUSTRIES**

### **Additional issue – allow cost model for agriculture?**

63. In both full IFRSs and the IFRS for SMEs, the only instance in which fair value through profit or loss is required for a non-financial asset is agriculture (with a reliability exception where fair value cannot be reliably measured on initial recognition, in which case cost is used). Arguments in favour of the fair value through profit or loss model are set out in IAS 41.B14-B16. Arguments in favour of a cost model are set out in IAS 41.B17.
64. Full IFRSs allow a choice of cost model or fair value through P&L model for property, plant, and equipment, intangible assets, and investment property, subject to specified constraints. For each of those cases, the IFRS for SMEs includes only the (simpler) cost model; it allows the fair value model by cross-reference to full IFRSs.
65. Some propose that agriculture be treated similarly in the IFRS for SMEs. That is, a cost model should be added (it is only the exception in IAS 41, not a basic model) and the fair value model should be an option by cross reference to IAS 41. Arguments in favour of the cost model are those in IAS 41.B17 – in an SME context fair valuation is a particularly onerous burden, the cost model is understandable, greater objectivity, lack of fair value data in developing economies and for certain kinds of agricultural assets, and consistency with model in the IFRS for SMEs for other non-financial assets. Arguments against are those in IAS 41 B14-B16, particularly difficulty in measuring cost and the need for relatively arbitrary allocations, lack of meaningfulness of cost, management of most agricultural entities on a fair value basis, and availability of fair value data.
66. On balance, for the reasons noted in the last sentence of the preceding paragraph, staff favours retaining the fair value through P&L model, with the reliability exception, in the IFRS for SMEs, rather than adding a cost model.

<b>Issue: Does the Board concur with the staff recommendation not to add a cost option for agriculture to the IFRS for SMEs?</b>
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## **SECTION 39 FIRST-TIME ADOPTION OF IFRSs FOR SMEs**

67. This section is new (it was not in the May 2006 draft). Staff's intent in drafting Section 39 was consistency with the approach to first-time adoption in IFRS 1 except that the general impracticability exception in paragraph 39.8 has been added. Many respondents to the Board's SME discussion paper said that SMEs do not have the records or the resources to enable any retrospective

application, and that the Board should provide only for prospective adoption. The approach taken in Section 39 – retrospective application for one prior year, unless impracticable – provides relief for an SME. Impracticable is defined in the glossary identically to the definition in IFRSs.

**Issue: Does the Board concur with the staff recommendation of an impracticability exception for restating the comparative data at first-time adoption?**

## GLOSSARY

68. At its meeting in May 2006 the Board decided:
- Glossary.** The definitions in the glossary should be conformed to those in the 2006 Bound Volume of IFRSs, or the difference should be explained.
69. Because several Board members expressed concern, at the May meeting, that “many” of the 93 definitions in the May 2006 draft glossary appeared to differ from those in the 2006 Bound Volume (BV 2006), staff reviewed each definition. The glossary in the June 2006 draft ED reports the results of that review in [bracketed] comments highlighted in yellow following each definition. The great majority of the definitions are identical to BV 2006.
70. As a result of the review, the following 11 definitions were all conformed in the June 2006 draft glossary:
- a. Accrual basis
  - b. Depreciable asset
  - c. Finance lease
  - d. Financial position
  - e. Material
  - f. Net realisable value
  - g. Notes to financial statements
  - h. Performance
  - i. Revenue
  - j. Separate financial statements
  - k. Subsidiary
71. The following definitions in the June 2006 draft ED of the IFRS for SMEs are different than in the 2006 Bound Volume (BV 2006) glossary for reasons indicated. None of these differences is intended to change meaning, just to improve clarity:
- a. **Employee benefits** – the clause “, including salaries and wages, short-term employee benefits, post-employment benefits,” has been added for clarity.
  - b. **Fair value** – the clause “or an equity instrument granted could be exchanged” has been added because that is part of the Board’s latest working definition of fair value.
  - c. **Financial statements** – The glossary in the IFRS for SMEs defines them as “Structured representation of the financial position, financial

performance and cash flows of an entity.” The definition in the BV 2006 glossary lists the financial statements required by IAS 1 but does not define the term “financial statements”.

- d. **Gains** – The glossary in the IFRS for SMEs defines them as “increases in economic benefits that meet the definition of income but that are not revenue”. (Both income and revenue are defined terms.) The BV 2006 glossary does not define them; it just says they are not different from revenue. But this is not helpful to anyone trying to decide how to report.
- e. **Going concern** – Staff believes that the definition in the IFRS for SMEs is identical to what is intended in the BV 2006, but BV 2006 begins its definition of going concern with “the financial statements are prepared on a going concern basis” without defining “going concern basis”.
- f. **Intangible asset** – BV 2006 defines this as “An identifiable non-monetary asset without physical substance.” The IFRS for SMEs begins with these identical words but then adds the following from IAS 38 to explain the word “identifiable”, which is a key word in the definition:

Such an asset is identifiable when it:

- (a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
  - (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
- g. **Interim financial report** – The only difference is removal of references to IAS 1 and IAS 34 that are in BV 2006 (such references to IASs are not normally in other definitions and don’t work in the IFRS for SMEs).
  - h. **Inventories** – The IFRS for SMEs definition is identical to BV 2006, but BV 2006 elaborates as follows to a degree that staff concluded is more than needed in the IFRS for SMEs:

“Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the entity and include materials and supplies awaiting use in the production process. In the case of a service provider, inventories include the costs of the service, as described in IAS 2 paragraph 19, for which the entity has not yet recognised the related revenue (see IAS 18)”
  - i. **Joint venture** – The second sentence of the definition in the IFRS for SMEs is added for clarity: “Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.”
  - j. **Operating lease** – The BV 2006 glossary says that an operating lease is any lease that is not a finance lease. The definition in the IFRS for SMEs defines an operating lease as “A lease that does not transfer substantially all the risks and rewards incidental to ownership.” Since finance lease is defined as one that transfers substantially all of the risks and rewards

incidental to ownership, the IFRS for SME definition is identical but clearer.

- k. **Profit** – is defined in the IFRS for SMEs as “The residual amount that remains after expenses have been deducted from income.” Profit is defined in BV 2006 as “The residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. Any amount over and above that required to maintain the capital at the beginning of the period is profit.” Capital maintenance adjustments are not mentioned in the IFRS for SMEs definition because (a) IFRSs do not provide for them in measuring profit generally and (b) SMEs are not likely to know what this means without considerable elaboration.
- l. **Property, plant, and equipment** – is defined in the IFRS for SMEs as “Tangible assets that:
  - a. are held for use in the production or supply of goods or services, for rental to others, for investment, or for administrative purposes, and
  - b. are expected to be used during more than one period.”The BV 2006 definition is identical except it begins “Tangible items that...” “Asset” is a defined term. “Item” is not. Staff believes use of the word “assets” is clearer.
- m. **Understandability** – The IFRS for SMEs glossary has slightly paraphrased the first few words from the BV 2006 glossary to form a true definition. BV 2006 says “Information provided in financial statements has the quality of understandability when [it] is comprehensible to users...” That is not really a definition of “understandability”. The paraphrase in the IFRS for SMEs merely converts this to a definition.
- n. **Share-based payment** – BV 2006 defines “share-based payment arrangement” but not “share-based payment”. While the June 2006 draft ED of the IFRS for SMEs defines “share-based payment” by rewriting the 2006 BV definition of share-based payment arrangement, on reflection staff proposes to change to “share-based payment arrangement” in the IFRS for SMEs.

<b>Issue: Does the Board wish to modify any of the foregoing (or other) definitions in the glossary??</b>
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