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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **26 May 2006, London**

Project: **Accounting Standards for Small and Medium-sized Entities (Agenda Paper 11)**

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1. Agenda Paper 11 is the staff memo identifying issues for discussion relating to the following three documents, which are attachments to Agenda Paper 11:
   a. Attachment A is a marked version of the revised draft Exposure Draft *International Financial Reporting Standard for Small and Medium-sized Entities* ['revised draft ED']. It reflects all changes since the version discussed at the January, February, and March 2006 Board meetings.
   b. Attachment B is a clean version of the revised draft ED.
   c. Attachment C is the first draft of a Glossary that will be incorporated into the ED.
2. This Agenda Paper identifies a number of specific issues for Board discussion in May 2006. These are presented enclosed in a "box".

What Is Left to Draft?

Derivation table.

3. Nearly all of the paragraphs in the revised draft ED include – generally at the end of the paragraph and in [square brackets] –a reference to the paragraph in an IAS or IFRS to which the paragraph in the revised draft ED relates. These will be deleted in the IFRS for SMEs and, instead, will be included in a 'Derivation Table', consistent with the Board's decision January 2006. They have been retained in the individual paragraphs, for now, for ease of keeping track of them. Conversion into a 'Derivation Table' should be straightforward.

Disclosure section

4. The draft ED currently includes the disclosures within each of the sections of the draft. Consistent with the Board's decision February 2006, all of the disclosures will be moved to a separate disclosure section. Staff plans to do that in the next revision to the draft ED.

5. The disclosures relating to financial instruments (Section 12, currently beginning paragraph 12.28) remain to be drafted. Staff plans to draft these disclosures after the Board's review of Section 12 in May 2006.

Model financial SME financial statements and notes

6. The draft ED currently includes the model financial statements from IAS 1 and IAS 7. Those do not include notes. Some aspects of those statements are changing due to the current IAS 1 ED. A senior manager from one of the international accounting and auditing firms, who works directly in the IFRS area, is reworking the model financial statements into an SME version with notes and monetary amounts. Staff plans to include them in the next revision to the draft ED.

Section on First-time Adoption

7. The Board has agreed that because first-time adoption provisions will be affected by the nature of the IFRS for SMEs, drafting of this section should await fairly solid decisions on the rest of the ED. Staff believes that after the May 2006 meeting it will be in a position to draft this section.

Basis for conclusions

8. Staff simply did not have time to draft it for the May 2006 meeting. Staff plans to have a draft for consideration at the June 2006 meeting. The following matters, among others, are in the current outline for the basis for conclusions:

   a. Why an International Financial Reporting Standard for SMEs is needed.

   b. IASB's definition of the objective of financial statements of SMEs.

   c. Why determination of taxable income and determination are not specific objectives of the IFRS for SMEs.

   d. Why it is not the purpose of the IFRS for SMEs to provide information to owner-managers to help them make management decisions.

   e. For which entities is the IFRS for SMEs intended and not intended.

   f. IASB's definition of an SME, including public accountability principle, presumptive indicators of public accountability, no size test.

   g. Why the IFRS for SMEs is not intended for small listed companies, and yet how jurisdictions might use it to develop their own standards for such companies.

   h. Why IASB Framework and principles and mandatory guidance in IFRSs are the appropriate starting point for developing the IFRS for SMEs.

   i. Basis for IASB decisions to modify those principles and guidance in the IFRS for SMEs.

   j. Why starting with the IASB Framework and principles and mandatory guidance in IFRSs is not forcing a fair value model on SMEs, as some assert.

k. All options in IFRSs should be available in the IFRS for SMEs.

l. Why include cross-references to IFRSs.

m. Mandatory fallback.

n. Why separate volume rather than as added sections in each IAS/IFRS.

o. Why organisation by topic.

p. The Board's plan for maintaining (updating) the IFRS for SMEs.

Invitation to comment

9. Staff plans to draft this for consideration by the Board at the June 2006 meeting.

Special purpose entities

10. Staff plans to add a paragraph to Section 10 *Consolidated Financial Statements* dealing with consolidation of special purpose entities.

Issue: Do Board members identify any omissions other than those noted above?

PREFACE AND SECTION 1 SCOPE

11. At the Board's request, the previous Introduction section was split into a Preface and a Scope section. The Board's objective was to make the structure of the IFRS for SMEs more consistent with the structure of IFRSs. Staff notes that in nearly all IASs/IFRSs the "scope" section defines which events, transactions or circumstances are addressed in the standard (ie scope of topics covered). In the IFRS for SMEs, the "scope" section defines the entities for which the standard is intended (ie, scope of application). Staff believes that this is clearly stated in paragraph 1.1 and does not propose any change.

Issue: Has the conversion from Introduction to Preface and Scope reflect the Board's decisions and achieved the Board's objective?

Definition of SME in paragraph 1.2

12. After defining the principle of public accountability, the definition of SMEs identifies four presumptive indicators of public accountability:

An entity has public accountability if:

(a) it has filed, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market;

(b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment banking entity;

(c) it is a public utility or similar entity that provides an essential public service; or

(d) 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.

13. The IASB SME Working Group, in their report to the Board following their January 2006 meeting, expressed general support for the IASB definition of an SME. They made two recommendations:

    (a) WG members agree that the Board should keep in mind an SME with about 50 employees and €10 million turnover in developing the IFRS for SMEs. WG members would explicitly make clear in the IFRS for SMEs that the Board had entities of this size in mind when developing the standards.

    (b) WG members generally would delete the third and fourth presumptive indicators of a publicly accountable entity – that it is a public utility or it is economically significant in its home country and leave that to local jurisdictions to decide.

14. Regarding recommendation (a), the current approach of defining public accountability is a principles-based approach. WG members do not recommend changing that approach. Their recommendation is that in the basis for conclusions the Board indicate that it had this size entity in mind when developing the standards. They believe this will help jurisdictions decide which entities should use the IFRS for SMEs. They also believe it might encourage jurisdictions to “push down” full IFRSs to large unlisted entities.

15. Staff supports this recommendation, though staff would include reference only to the 50 employee size in the basis for conclusions, but not the €10 million turnover because the latter is jurisdiction-specific.

Issue: Do Board members concur that the basis for conclusions should indicate that the Board had in mind an entity with about 50 employees in developing the IFRS for SMEs and that each individual jurisdiction must decide which non-publicly accountable entities should be required, permitted, or perhaps even prohibited to use the IFRS for SMEs.

16. Regarding recommendation (b), the WG Members recommend deletion of presumptive indicators (c) and (d). In the case of public utilities, it is hard to define “essential public service” and in many jurisdictions services commonly through of as essential public services, such as refuse collection, internet access, and water distribution, are provided by very small local entities. In the case of economically significant entities, WG members believe that size alone does not make an entity publicly accountable. The public accountability principle should focus on financial accountability – which is what indicators (a) and (b) do – and not political accountability. Staff concurs with the WG recommendation.

Issue: Do Board members agree with deletion of presumptive indicators (c) and (d)?

SECTION 2 CONCEPTS AND PERVASIVE PRINCIPLES

Pervasive recognition and measurement principles 2.39-2.51

17. At past meetings, some Board Members had expressed concern about inconsistencies of these principles with similar principles as stated in the Framework or in IFRSs. As Board requested, staff reviewed these and has rewritten them to make them, as much as possible, direct quotations from the

Framework or IFRSs, rather than paraphrases. Several in the previous draft have been deleted. The SME Working Group had recommended inclusion of such principles to reduce the need for an SME to look to full IFRSs for solutions to accounting questions.

Issue: Does the Board believe that these pervasive principles, as rewritten, should remain in the IFRS for SMEs? If so, do Board members have recommendations for additions, deletions, or improvements?

Expenses and losses

18. The distinction between expenses and losses is not clear in the IASB *Framework*, and consequently staff does not believe it is clear in the IFRS for SMEs either. Expenses are defined in paragraph 2.28 as "decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants." But then (as in the IASB *Framework*) paragraph 2.31 says that "the definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity." That paragraph goes on to say that losses are a subset of expenses and may or may not arise in the course of ordinary activities. No definition of losses is given. Staff recognises that the Board is currently working on revisions to the *Framework*. As the IFRS for SMEs is currently drafted, the anomaly from the existing *Framework* is carried forward. This is consistent with the staff's approach in all other sections of the IFRS for SMEs except for some changes that reflect the current Exposure Draft of Amendments to IAS 1. Staff does acknowledge, though, that the guidance for distinguishing losses from other expenses is not particularly helpful.

Issue: Is the Board satisfied to retain the existing *Framework* definitions and descriptions of expenses and losses in the draft SME ED?

3 GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION

Complete set of SME financial statements

19. At the February 2006 Board meeting, the Board recommended that the staff consider the current Exposure Draft of Amendments to IAS 1 *A Revised Presentation* in developing the IFRS for SMEs. One result of doing so is reflected in paragraph 3.10, which defines a complete set of SME financial statements. With regard to reporting 'performance', paragraph 3.10 requires either:

    (a) an income statement (described in this Standard); or

    (b) separate statements of profit and loss and of recognised income and expense (as described in IAS 1 *Presentation of Financial Statements* (revised 2006)).

20. This is an example of an accounting policy choice where one option is described in the IFRS for SMEs (generally the simpler option) while the other is described via cross-reference to an IFRS. However, this is the <u>only</u> case in the IFRS for SMEs where the cross-reference is not to an existing IFRS but to

an Exposure Draft. In the case of the expected ED on borrowing cost, which would eliminate the immediate expensing option, this has been handled in the draft SME ED by a footnote. Staff believes that the issue of separate statements of profit and loss and of recognised income and expense should similarly be handed by footnote, and therefore paragraph 3.10(b) should be deleted, for two reasons:

(a) Comments on the matter in 3.10(b) should be handled via responses to the IAS 1 Amendments ED, not as responses to the IFRS for SMEs ED.

(b) If 3.10(b) is retained as an IASB SME proposal, this approach would have to be illustrated in the model financial statements, making them more complex.

Issue: Does the Board support the staff recommendation that paragraph 3.10(b) should be deleted and replaced with a footnote indicating the proposal in the IAS 1 Amendments ED *A Revised Presentation*?

Titles of the financial statements

21. Staff has changed the titles of all of the financial statements as used in the revised draft ED of the IFRS for SMEs to conform to those used in the ED of Amendments to IAS 1, with one exception. The term "income statement" has been retained, rather than "statement of recognised income and expense", because of (a) simplicity for SMEs, (b) it is still a proposal, and (c) the proposal states that entities may choose a different title for the statement.

Issue: Does the Board concur with changing all of the titles other than income statement in the IFRS for SMEs?

Statement of income and retained earnings

22. At the February 2006 Board meeting, the Board decided that if the only changes to an SME's equity during a period arise from profit or loss and payment of dividends, the SME may present a combined statement of income and retained earnings. Paragraph 3.11 provides for this. The content of that statement is described in Section 7.

23. At the February 2006 Board meeting, the Board did not consider whether an SME should be eligible to present a combined statement of income and retained earnings if its equity changes due to (a) correction of a prior period error or (b) change in accounting policy (in addition to changes due to profit and loss and dividends)? Staff believes that equity changes due to restatements for error corrections and accounting policy changes are different from equity changes due to items of income and expense that are recognised directly in equity (such as certain translation gains and losses, fair value changes of available for sale financial assets, and actuarial gains and losses). It is the latter that the Board intends to capture in the statement of recognised income and expenses. Therefore the staff recommends that an SME be eligible to present a combined statement of income and retained earnings if its equity changes due to (a) correction of a prior period error or (b) change in accounting policy, in addition to changes due to profit and loss and dividends?

Issue: Does the Board concur with the staff recommendation?

SECTIONS 4 TO 9

24. Staff does not have any recommendations regarding the following sections beyond the recommendation relating to Section 7 *Statement of Income and Retained Earnings* that was made in paragraph 23 above. In February 2006 the Board decided that Section 8 on the cash flow statement should illustrate only the indirect method. An SME electing the direct method would be cross-referred to IAS 7 for guidance.

    4 STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

    5 INCOME STATEMENT

    6 STATEMENT OF CHANGES IN EQUITY

    7 STATEMENT OF INCOME AND RETAINED EARNINGS

    8 STATEMENT OF CASH FLOWS

    9 NOTES TO THE FINANCIAL STATEMENTS

    GUIDANCE ON IMPLEMENTING SECTIONS 5 TO 9 – ILLUSTRATIVE FINANCIAL STATEMENT STRUCTURE

Issue: Do Board members have any recommendations regarding the above Sections?

SECTION 10 CONSOLIDATED FINANCIAL STATEMENTS

25. At its February 2006 meeting the Board concluded:

    Consolidation. An SME group (parent and one or more subsidiaries) will be required to prepare consolidated financial statements. The IFRS for SMEs will include only the basic principles for consolidation, with a cross-reference to IAS 27 for detailed guidance.

    Combined financial statements. Guidance should be added regarding preparation of combined financial statements of two SMEs controlled by the same shareholder(s). Guidance would require elimination of intercompany profits, and related party disclosures.

26. Staff had also noted, at that meeting, that guidance on separate company financial statements needed to be added. The current draft of Section 10 reflects all of the foregoing. Staff makes no further recommendations.

Issue: Does the Board concur that Section 10 appropriately reflects the Board's decisions? Are modifications needed?

27. Paragraph 10.8 of the draft ED for SMEs provides (as do IAS 27, 28, and 31) that in separate company financial statements jointly controlled entities and associates that are not held for sale may be accounted for either at cost or at fair value through P&L:

    10.8 Paragraph 10.1 requires that when a parent prepare consolidated financial statements when it has one or more subsidiaries. This Standard does not require that a parent must also produce **SEPARATE COMPANY FINANCIAL STATEMENTS** (for the parent entity or for the subsidiaries) in addition to the consolidated statements. When separate company financial statements are prepared, investments in subsidiaries, **JOINTLY CONTROLLED ENTITIES** and **ASSOCIATES** that are not classified as held for sale shall be accounted for either:

(a) at cost, or

(b) at fair value through profit or loss

An entity shall apply the same accounting shall be applied for each category of investments in its separate company financial statements.

28. The criteria for FV through P&L in IAS 39 are different from those in Section 12. IAS 39 has four classifications of financial assets and a fair value option. The SME ED has two classifications. Paragraph 12.4 states:

12.4 Financial assets shall be classified as measured at fair value through profit or loss only if:

(a) they have an observable market price and either they can easily be sold or management is committed to a plan to sell the asset; or

(b) they are derivative financial assets.

29. With regard to the option in 10.8 to measure investments in JVs and associates at FV through P&L in separate company statements, there is no requirement that "they have an observable market price and either they can easily be sold or management is committed to a plan to sell the asset".

30. Staff believes that the option in 10.8 and 12.4 do not conflict. That is, the option in 10.8 is the standard for separate company statements independent of 12.4.

Issue: Does the Board concur that paragraphs 10.8 and 12.4 are not in conflict? Are modifications needed?

SECTION 11 ACCOUNTING POLICIES, ESTIMATES, AND ERRORS

Mandatory fallback

31. The Board has discussed at several meetings the issue of the "mandatory fallback" to IFRSs if the IFRS for SMEs does not specifically address a transaction, other event, or condition that is addressed in IFRSs. Paragraphs 11.2 and 11.3 reflect the Board's decision.

32. The "mandatory fallback" is probably the most troublesome issue for the Board in dealing with the SME project. Many constituents have said that the fallback is not consistent with the goal of simplification. The dilemma for the Board is what, if any, guidance to provide for an SME that happens to encounter one of these events or transactions. Staff believes that it is not appropriate that the IFRS for SMEs suggest (explicitly or by silence) that any accounting an SME wishes is acceptable. Staff has tried to limit the need to fallback to IFRSs to specific, cross-referenced issues by providing sufficient guidance for other matters directly in the SME standard. Staff has no recommendation on this matter.

Issue: Is the Board satisfied with the treatment of the mandatory fallback as set out in 11.2 and 11.3?

SECTION 12 FINANCIAL ASSETS AND FINANCIAL LIABILITIES

33. Staff wishes to point out that this section is new and that disclosure remains to be drafted. With regard to financial assets, the Board's tentative decision is to have only two categories of financial assets for SMEs, rather than the four in IAS 39:

    a. amortised cost; and

    b. fair value through profit and loss.

    Fair value through profit and loss would be used only for the following types of financial assets:

    a. Those for which there is an observable market price and either (a) the SME intends to sell or (b) there is a liquid market

    b. All derivatives.

    All other financial assets would follow the amortised cost approach.

    Of course, if impairment is indicated, the SME must calculate recoverable amount.

34. Staff has drafted this section based on these principles.

Issue: What are Board Members' views on this new Section 12?

SECTION 13 INVENTORIES

35. Staff wishes to point out that the discussion on write-down of inventories to net realisable value is included in Section 27 *Impairment of Assets* (which is a general impairment section covering all non-financial assets) consistent with the Board's March 2006 decision. Staff has no recommendations on this section.

SECTION 14 INVESTMENTS IN ASSOCIATES

36. At its February 2006 meeting, the Board decided:

    Investments in associates Allow an SME to elect (a) the cost method with impairment or (b) fair value through profit and loss or (c) equity method. Cross-reference to IAS 28 would replace the details of the equity method. Do not require conformity of accounting policies of the associate and investor. If the cost or fair value method is used, intercompany profits would not be eliminated, but related party disclosures would be required.

Issue: Does the Board believe that Section 14 appropriately reflects the Board's decisions?

SECTION 15 INVESTMENTS IN JOINT VENTURES

37. At its February 2006 meeting, the Board decided:

    Investments in joint ventures Allow an SME to elect (a) the cost method with impairment or (b) fair value through profit and loss or (c) equity method or (d) proportionate consolidation. Cross-reference to IAS 31 would replace the details of methods (c) and (d). If the cost or fair value method is used, intercompany profits would not be eliminated, but related party disclosures would be required.

Issue: Does the Board believe that Section 15 appropriately reflects the Board's decisions?

SECTION 16 INVESTMENT PROPERTY

38. At its February 2006 meeting, the Board decided:

Investment property The section on investment property should be brief. A simple definition of investment property should be included in the glossary. The IAS 40 accounting policy choice of (a) cost-depreciation-impairment model and (b) fair value through profit and loss model should be retained. An SME electing (a) should be referred to the property, plant, and equipment section of the IFRS for SMEs for guidance. An SME electing (b) should be referred to IAS 40.

Issue: Does the Board believe that Section 16 appropriately reflects the Board's decisions?

SECTION 17 PROPERTY, PLANT AND EQUIPMENT

39. At its February 2006 meeting, the Board decided:

Property, plant, and equipment SMEs should be permitted to use the revaluation model, with a cross-reference to IAS 16 for guidance on applying it.

Assets held for sale Instead of a separate section these requirements should be included in the section on property, plant, and equipment.

Issue: Does the Board believe that Section 17 appropriately reflects the Board's decisions?

SECTION 18 INTANGIBLE ASSETS OTHER THAN GOODWILL

40. Staff asks the Board to reconsider its previous decision not to add an option for an SME to expense all development costs.

41. Paragraph 18.12(b) of the draft ED for SMEs repeats the IAS 38 requirement to capitalise certain development costs:

(b) An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

(i) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(ii) its intention to complete the intangible asset and use or sell it;

(iii) its ability to use or sell the intangible asset;

(iv) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(v) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(vi) its ability to measure reliably the expenditure attributable to the intangible asset during its development. [IAS 38.57]

42. The Board, the SME Working Group, and a number of participants at the SME roundtables have noted that the necessity to demonstrate these six circumstances has the effect of making capitalisation of development costs a 'de facto' option. The WG, many respondents to the recognition and measurement questionnaire, and many roundtable participants recommended that the Board make this option explicit. In their view, this would make the IFRS for SMEs more understandable. By adding an expense option, rather than removing the ability to capitalise development costs when the six conditions are met, the Board would still be consistent with its view that all accounting policy choices under IFRSs should be available to SMEs. For these reasons, staff favours adding the expensing option for development costs.

Issue: Does the Board agree with the staff recommendation to add an option in Section 18 that explicitly permits charging all development costs to expense when incurred?

SECTION 19 BUSINESS COMBINATIONS AND GOODWILL

43. At its February 2006 meeting, the Board decided:

Business combinations SMEs need not separate out acquired indefinite-life intangible assets from goodwill, but would separate definite-life intangible assets.

44. In preparing this agenda paper – which was done after the revised draft ED was distributed to the Board – staff realised that the foregoing decision is not explicitly reflected in the draft ED. Staff will make the revision in the next draft for consideration by the Board in June 2006.

45. At its February 2006 meeting, the Board decided:

Goodwill and indefinite-life intangible assets that are separated from goodwill An SME would be required to do an impairment test only if there is an indication of impairment. The Board did not support an amortisation approach.

Issue: Does the Board believe that Section 19 appropriately reflects the Board's decisions?

SECTION 20 RIGHTS AND OBLIGATIONS UNDER LEASES

46. The distinction between operating and finance leases has been maintained, consistent with the Board's February 2006 decision.

Issue: Does the Board believe that Section 20 appropriately reflects the Board's decisions?

SECTION 21 PROVISIONS AND CONTINGENCIES

47. At its February 2006 meeting, the Board decided:

Provisions Staff should consider whether this section can be simplified and which of the examples in the appendix to IAS 37 should be included in the IFRS for SMEs. Address restructurings and onerous contracts as examples.

48. The revised draft ED reflects a major simplification. Since IAS 37 is similar to the UK standard on provisions, the simplification of this Section of the IFRS for SMEs is based on the section of the FRSSE dealing with provisions. Those examples from IAS 37 that are deemed relevant to typical SMEs have been added to this Section. Restructurings, onerous contracts, and provisions for future losses have been added as examples.

Issue: Does the Board believe that Section 21 appropriately reflects the Board's decisions?

SECTION 22 EQUITY

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

Classification of instruments as debt or equity The exposure draft will acknowledge that the IASB and FASB are working jointly on standards for classifying puttable shares and similar instruments as debt or equity and will indicate that the final IFRS for SMEs would reflect the decision(s) in that project.

50. A footnote has been added indicating the current Board project on puttable and redeemable equity. Section 22 may need updating if a proposal is issued.

Issue: Does the Board believe that Section 22 appropriately reflects the Board's decisions?

SECTION 23 REVENUE

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

Construction contracts Use the percentage of completion method, provided that the stage of completion, future costs, and collectibility can be estimated reliably. Include the standards on construction contracts in the section on revenue.

52. Consistent with this decision, the guidance on construction contracts has been moved to this section, and the section on construction contracts in the previous draft has been deleted.

53. Staff also wishes to point out that several of the revenue recognition examples from IAS 18 that had been included in the previous draft SME ED have been deleted because they relate to revenue recognition by banks and other financial institutions, which by definition of SME cannot use the IFRS for SMEs.

Issue: Does the Board believe that Section 23 appropriately reflects the Board's decisions?

SECTION 24 GOVERNMENT GRANTS

54. 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).

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

SECTION 25 BORROWING COSTS

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

Borrowing costs Only the expense model will be included in the IFRS for SMEs. However, an SME could choose to use the capitalisation model by applying IAS 23 *Borrowing Costs*. The ED will note that the IASB has agreed to issue an exposure draft of an IFRS proposing to prohibit the expense model and invite comments on whether that is appropriate for SMEs as well.

Issue: Does the Board believe that Section 25 appropriately reflects the Board's decisions?

SECTION 26 SHARE-BASED PAYMENT

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

Share-based payment The IFRS for SMEs will address cash-settled options and will refer back to IFRS 2 *Share-based Payment* with respect to equity-settled share-based payments. The IFRS for SMEs will note that IFRS 2 permits the use of the intrinsic value method if fair value cannot be reliably measured.

Issue: Does the Board believe that Section 26 appropriately reflects the Board's decisions?

SECTION 27 IMPAIRMENT OF ASSETS

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

Impairment of non-financial assets This section will cover all non-financial assets in one place. The principle would be that non-financial assets other than inventories should not be measured at more than fair value less cost to sell. Inventory should not be measured at more than net realisable value.

58. Staff would propose to change the title of this section to Impairment of Non-financial Assets. No other staff recommendation.

Issues:

Does the Board concur with adding 'Non-Financial' in the title?

Does the Board believe that Section 27 appropriately reflects the Board's decisions?

SECTION 28EMPLOYEE BENEFITS

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

Employee benefits This section will include standards for:

- short term benefits;
- the following kinds of retirement plans: multi-employer plans, state plans, insured plans, and defined contribution plans. However, defined benefit retirement plans will be addressed by cross-reference to IAS 19;
- other long term benefits (including deferred compensation and long-service payments) and termination benefits (measure at discounted present value, actuarial valuation not required, need not use the projected unit credit method).

Issue: Does the Board believe that Section 28 appropriately reflects the Board's decisions?

SECTION 29 INCOME TAXES

60. Staff wishes to point out that this section is entirely new. It is based on the Board's decisions at its March 2006 meeting, as follows:

Income taxes Deferred tax assets and liabilities will be recognised for all taxable differences between the carrying amounts and the tax bases of assets and liabilities (the various exceptions and special rules in IAS 12 *Income Taxes* would be eliminated). Staff indicated that it will consider whether to make a special recommendation to the Board regarding deferred tax assets arising from operating loss carryforwards.

Issue: Does the Board believe that Section 29 appropriately reflects the Board's decisions?

SECTIONS 30 TO 37

61. Staff made few changes to the following sections since the previous draft and has no recommendations regarding any of them.

SECTION 30 FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

SECTION 31 FOREIGN CURRENCY TRANSLATION

SECTION 32 SEGMENT REPORTING

SECTION 33 EVENTS AFTER THE END OF THE REPORTING PERIOD

SECTION 34 RELATED PARTY DISCLOSURES

SECTION 35 EARNINGS PER SHARE

SECTION 36 SPECIALISED INDUSTRIES

SECTION 37 DISCONTINUED OPERATIONS

Issue: Do Board Members have any comments or recommendations on Sections 30 to 37?

SECTION 38 INTERIM FINANCIAL REPORTING

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

    Interim financial reporting Instead of having a separate section on interim reporting, the IFRS for SMEs will cross-refer to IAS 34 *Interim Financial Reporting* for guidance. However, the IFRS for SMEs will expressly permit an entity that is not subject to a periodic interim reporting requirement to present, as comparative information, a statement of income and retained earnings (or separate income and equity statements) and a cash flow statement of the immediately preceding year when the year-to-date comparative statements otherwise required by IAS 34 have not been prepared previously.

Issue: Does the Board believe that Section 38 appropriately reflects the Board's decisions?

SECTION 39 FIRST-TIME ADOPTION OF IFRSs FOR SMEs

63. To be written – no staff recommendations at this time.

GLOSSARY

Citations

64. As noted in paragraph 15 of the Preface, definitions of key terms are included in a glossary. The first time a key term is used in a section, it is shown in **SMALL CAPITAL LETTERS UNDERLINED**. The Glossary is Attachment C to this agenda paper.

Nature of the glossary

65. The Glossary in the IFRS for SMEs is different from the one in the Bound Volume of IFRSs.

    (a) The glossary in the bound volume is a compilation of definitions that are also set out in the individual IASs, IFRSs, and Interpretations. The individual standards can stand on their own without the glossary. The cross-references in the Bound Volume glossary indicate the source of the definition. On occasion, the same term is defined slightly differently in two or more standards, and the glossary includes both definitions with cross references.

    (b) The glossary in the IFRS for SMEs, on the other hand, is the original source of the definitions of key terms that are used in the individual standards. It is not a compilation of definitions introduced elsewhere in the IFRS for SMEs. The glossary is an indispensable part of the IFRS for SMEs, rather than a helpful supplement. Because there is no "source definition" in the body of the IFRS for SMEs of the terms in the glossary, the glossary does not include cross-references.

Issue: Does the Board concur with the foregoing approach? Do Board Members have suggestions for additional defined terms?

Some definitions retained in the text of the standards

66. In a few sections of the IFRS for SMEs, some definitions have been retained in the text because they are necessary in context for an understanding of the standards.