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International Accounting Standards Board

This document is provided as a convenience to observers at the SME Working Group meeting, 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 a staff paper prepared for the SME Working Group. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers may not be used (these are indicated).

INFORMATION FOR OBSERVERS

Project:	**IFRS for Small and Medium-sized Entities**
Meeting:	**SME Working Group, 10-11 April 2008, London**
Paper:	**Overview of Key Issues Raised in Comment Letters and Project Plan (Agenda Paper 1)**

Objective of Discussion at this Working Group Meeting

1. At the April 2008 Working Group (WG) meeting, the staff will:
   a. Present a summary of the issues raised in the letters of comment on the Board's February 2007 Exposure Draft (ED) of a proposed International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs):
      i. Issues other than disclosure issues are presented in Agenda Paper 1 (this paper).
      ii. Disclosure issues are presented separately in Agenda Paper 4.
   b. Present a summary of the problems encountered by the 116 SMEs that participated in field testing the ED – Agenda Paper 2.
   c. Provide, as Agenda Paper 3, a combined 'inventory' of the principal substantive issues resulting from the analyses of the comment letters (Agenda Paper 1) and field tests (Agenda Paper 2). The purpose of Agenda Paper 3 is to make the Working Group discussion easier by integrating the two sets of issues in Agenda Papers 1 and 2. <u>Agenda Paper 3 will not introduce any new issues.</u>
   d. Seek the views of WG members on each of the issues in Agenda Papers 3 and 4 and any other views of WG members on the proposed IFRS for SMEs.

2. A report of the views of the WG members will be provided to the Board as input to the Board's redeliberations of the ED, which will begin in May 2008. The process for developing that report will be as follows:

   a. Based on discussions at the WG meeting, staff will prepare a first draft of the WG's report and send it to WG members by 16 April 2008 for comment.

   b. To meet the deadline for the IASB May meeting papers, we will ask for comments on the draft report by 23 April 2008 (<u>one week turnaround</u>). Where there is a general consensus among WG members, the report will so indicate, with WG members' reasons. Where the WG is divided, the report will indicate the differing views and arguments put forward.

3. At the April 2008 WG meeting, staff will also present, as Agenda Paper 5, the plans of the IASC Foundation education staff for training materials for the IFRS for SMEs. The Agenda Paper will include two sample sections of the draft training materials. WG members will be invited to comment on the plan and draft materials.

4. At the March 2008 IASB meeting, the need to obtain further views from users of SMEs' financial statements was discussed. The Board noted that there was only limited response from users in the comment letters on the ED. Particularly in the area of disclosure, it would be helpful to have additional views of users as part of the process of finalising the IFRS for SMEs. The Board discussed whether a user questionnaire on disclosures might be useful, though some concern was expressed that a user questionnaire should not delay the final SME standard. The Board suggested that staff seek ideas from the WG on possible courses of action, if any.

Last Meeting of the Working Group

5. The WG last met on 30-31 January 2006. At that meeting, the principal agenda paper was a complete though preliminary draft of an ED of an IFRS for SMEs. The WG discussed the general approach, organisation, and content of the preliminary draft ED. A Summary of Views Expressed by Working Group Members was provided to the Board in advance of the Board's February 2006 meeting – which was the meeting at which the Board began its own consideration of the preliminary draft ED.

Project Activities since the Last Working Group Meeting

Publication of the ED

6. The Board published the ED of a proposed IFRS for SMEs for comment in February 2007. Comment deadline was 30 November 2007 – extended from the original deadline of 1 October 2007 to allow companies and organisations participating in field tests to factor the results into their comment letters.

Translations of the ED

7. Translations of the ED were published and posted on the IASB's website as follows:

   - Spanish April 2007

- French May 2007
- German June 2007
- Polish September 2007
- Romanian September 2007

Letters of Comment on the ED

8. The Board received 162 letters of comment on the ED. These have been made available to Board members and posted on the IASB's website.
9. Thirteen comment letters were submitted in a language other than English (French 3, German 1, Portuguese 1, and Spanish 8). We had these professionally translated for the purpose of preparing the comment letter analysis.
10. This Agenda Paper (starting with paragraph 19) identifies the key issues raised in the letters of comment.

Staff Overview of the ED

11. A 17-page staff overview of the ED, in question-and-answer format, was published in April 2007 and posted on the IASB's website. The overview was intended as a high level introduction to the ED. As stated in the overview, the document was not approved by the International Accounting Standards Board. Nor was it intended to serve as the basis for commenting on the ED.

Field Testing of the ED

12. Subsequent to issuing the ED, the staff organised a programme of field testing of the ED. In total, 116 companies from 20 countries participated in the field tests.
13. Field test companies were asked to provide background information about the company, submit their most recent annual financial statements under their existing accounting framework, prepare financial statements in accordance with the proposed IFRS for SMEs for the same financial year (though without presenting comparative prior year information), and respond to a series of questions designed to identify specific problems the field test company encountered in applying the proposed IFRS for SMEs.
14. The staff analysis of the field test results is set out in Agenda Paper 2 for this WG meeting. Agenda Paper 2 also provides further background on the field testing, the demographics of the sample of entities involved, limitations noted during testing, and the issues identified by field test entities.

Compliance Checklist

15. In May 2007, we posted on the IASB's website a 111-page Compliance Checklist for the proposed IFRS for SMEs. The checklist was developed by one of the large international public accounting firms. The checklist identifies all of the accounting recognition and measurement requirements in Sections 3–38 of the ED. It was intended to allow users of the proposed IFRS for SMEs to identify quickly those sections and paragraphs that are directly relevant to them. We made it available in the expectation that some field testers would find it useful, though there was no obligation to use it. The checklist states that the document has not been reviewed or approved by the IASB.

Outreach

16. Staff has undertaken a greater-than-normal outreach effort in connection with this project. That effort included 96 roundtables and presentations in 39 jurisdictions in past four years, including the following since the ED was issued:

Location	Audience was N=National, R=Regional, G=Global
Austria	N
Belgium	R
Canada	N N N N R [5 different events]
Dubai	G
El Salvador	R
France	N
Germany	R N N
Holland	N
Honduras	N (Video)
Hong Kong	N
Hungary	N
Indonesia	N
Malaysia	R
Malta	G N
Mexico	R
Namibia	R
Poland	N
Romania	N
Singapore	R
South Africa	N N
Spain	N N
Switzerland	R
Thailand	N (Video)
Turkey	R
UK	N N G
Ukraine	R
USA	G G N N

17. In addition, the project was discussed at six meetings of the Standards Advisory Council and at five World Standard Setters' meetings. Also staff has published seven articles about the ED since the ED was issued, in English, Spanish, German, and (forthcoming) Ukrainian.

18. The foregoing summarises only those outreach activities undertaken by staff. In addition, many presentations made by Board members were devoted entirely or partly to the SME project.

Comment Letters on the ED

19. The analysis of the comment letters in this Agenda Paper is organised into three main parts:

    a. General issues relating to questions in the Invitation to Comment in the ED – not related to a particular section in the ED. The Invitation to Comment set out 11 questions at the front of the ED.

    b. Other general issues in the comment letters – not related to a specific section in the ED.

    c. Other issues in the comment letters – all of those related to a specific section in the ED.

20. All key issues raised in the 162 comment letters are summarised below in this Agenda Paper subject to the following:

    a. In analysing the letters, staff has classified as a 'key issue' any suggested change to the recognition, measurement, or presentation requirements proposed in the SME ED that was mentioned in more than two comment letters. Also, staff judged that several points raised in only one or two comment letters should still be included as 'key issues' because of the nature of the comments.

    b. In addition to the key issues set out below, staff has captured, outside of this Agenda Paper, all other points raised in only one or two comment letters and plans to review them for possible inclusion in Agenda Papers at future Board meetings.

    c. Key issues do not include those issues where the commentator said that more guidance is needed (Question 8 of Invitation to Comment). These are addressed separately starting in paragraph 81 of this Agenda Paper, after the key issues related to specific sections, under the heading 'Adequacy of Guidance'.

    d. Nor does the list below include disclosure changes proposed in comment letters (Question 9 of Invitation to Comment). Analysis of those is included in Agenda Paper 4.

    e. Staff has identified nearly 400 suggested editorial improvements that it will consider in redrafting the ED into a final IFRS for SMEs.

Issues Relating to Questions in the Invitation to Comment

21. **Stand-alone IFRS for SMEs (Question 1).** Over 60% of the comment letters that addressed the 'stand-alone' issue would eliminate <u>all</u> cross-references to full IFRSs, thereby making the IFRS for SMEs a fully stand-alone Standard. Another

35% of the letters either (a) would keep the number of cross-references to an absolute minimum or (b) were indifferent between having minimal cross-references and removing all cross-references. Only a few comment letters that addressed the stand-alone issue did not agree that the IFRS for SMEs should be a stand-alone document; instead, they would have special exemptions or simplifications for SMEs within full IFRSs.

22. Attachment A to this Agenda Paper contains a list of all of the cross-references to full IFRSs currently in the draft IFRS for SMEs. Most of the cross-references fall into one of two categories:

    a. **Omitted topics.** Topics omitted because they are thought not generally to be relevant for a typical SME with around 50 employees.

    b. **Accounting policy options.** The more 'complex' option in IFRSs when an IFRS allows an accounting policy choice.

23. **Omitted topics (Question 6).** Some topics in IFRSs are not addressed in the IFRS for SMEs because they are thought not generally to be relevant for an SME. Here is a list of those topics with annotation of the general views expressed in the letters of comment about each. The overall view in the letters of comment is that many of the omitted topics should be addressed explicitly in the IFRS for SMEs, rather than by cross-reference to IFRSs, while a few of the omitted topics need not be addressed or cross-referenced at all. Further, the guidance in the IFRS for SMEs should be simplified as compared to IFRSs:

    - **Lessor accounting for a finance lease.** – The ED refers to guidance and disclosures under IAS 17. In BC62 we indicated that many lessors in finance leases are likely to be financial institutions that would be ineligible to use the IFRS for SMEs. While many lessors may be financial institutions, the comment letters addressing this issue generally said SMEs often are lessors in finance leases. Therefore, in their judgement, this topic should be addressed in the IFRS for SMEs, rather than by cross-reference to IAS 17.

    - **Equity-settled share-based payments (SBP).** Cross-reference is to the measurement and disclosure guidance in IFRS 2. Comment letters addressing this issue generally said equity-settled SBP transactions are common to SMEs (respondents from Korea and Italy specifically said they are common in their countries) and, therefore, this topic should be addressed in the IFRS for SMEs, rather than by cross-reference to IFRS 2. Many of those letters also said that the intrinsic value method in IFRS 2 is not much of a simplification because it requires determination of fair value of the settlement shares (though not the option) at issuance and subsequent reporting dates.

    - **Share-based payment transactions with cash alternatives.** Again, the cross-reference is to the measurement and disclosure guidance in IFRS 2. Only a few comment letters said that this type of SBP is common to SMEs. But still, those letters felt this topic should be addressed in the IFRS for SMEs, rather than by cross-reference to IFRS 2.

    - **Functional currency is hyperinflationary.** SMEs whose functional currency is hyperinflationary are required to follow IAS 29 in full and the related part of IAS 21. A substantial number of comment letters said that this topic should be addressed in the IFRS for SMEs, rather than by cross-reference to IAS 29. Many suggested that SMEs would need only simplified guidance rather than the complete IAS 29.

- **Segment information.** If entity wishes to present information that is described as segment information, it is required to follow IFRS 8 in full. Most of the comment letters addressing this issue recommended that the IFRS for SMEs be silent on this issue rather than require full compliance with IFRS 8. A small number of comment letters felt the IFRS for SMEs should contain simplified guidance on segment reporting for SMEs for those entities wishing to present segment information.
- **Earnings per share.** If entity wishes to present any EPS data, the ED proposes to require the entity to follow IAS 33 in full. Most of the comment letters addressing this issue recommended that the IFRS for SMEs be silent on this issue rather than require full compliance with IAS 33. A small number of comment letters felt the IFRS for SMEs should contain simplified guidance on presenting EPS by SMEs for those SMEs wishing to present EPS data.
- **Biological assets whose fair value is readily determinable without undue cost or effort.** The IFRS for SMEs reduces the circumstances in which the fair value through profit or loss model is followed, as compared to IAS 41, by adding an exception if fair value is determinable only with undue cost or effort. But if the fair value through profit or loss model is followed, an SME is required to apply the fair value model in IAS 41 in full and to give disclosures required by IAS 41. Most of the comment letters addressing this issue recommended that some of the guidance on measuring fair value of biological assets that is in IAS 41 be included in the IFRS for SMEs, rather than a cross reference to 19 paragraphs of guidance in IAS 41.
- **Insurers** are outside the scope of IFRS for SMEs. Many letters of comment said that Section1, paragraph 1.2, clearly excludes insurers from the scope of the IFRS for SMEs. Therefore, there is no need for paragraph 35.3.
- **Interim financial reporting**. If entity wishes to present an interim financial report that is described as conforming to the IFRS for SMEs, it is required to follow IAS 34 in full (or to comply with the IFRS for SMEs in full). Most of the comment letters addressing this issue recommended that the IFRS for SMEs be silent on this issue. A small number of comment letters felt the IFRS for SMEs should contain simplified guidance on interim reporting for SMEs.

24. **Accounting policy options (Question 4).** The draft IFRS for SME*s* proposes that accounting policy options available under full IFRSs should generally also be available to SMEs. Guidance on the simpler option is included in the IFRS for SMEs. Guidance on the more complex option is included by cross-reference to the relevant full IFRS. The draft IFRS for SMEs currently includes the following accounting policy options by cross-reference to full IFRSs:

    - **Investment property –** fair value through profit or loss model (IAS 40).

- **Property, plant and equipment –** revaluation model (IAS 16).
- **Intangible assets –** revaluation model (IAS 38).
- **Borrowing cost –** capitalisation model (IAS 23) and related issue of including borrowing cost in inventories (IAS 2).
- **Presenting operating cash flows –** direct method (IAS 7).
- **Accounting for government grants –** any of the IAS 20 methods.
- **Development costs –** capitalisation model (IAS 38).
- **Associates –** equity method (IAS 28).
- **Joint ventures –** equity method and proportionate consolidation methods (IAS 31, but for the equity method IAS 31 further cross-refers to IAS 28).
- **Financial instruments –** use IAS 39 and IFRS 7 in full instead of Section 11. Also, SMEs choosing Section 11 are still given the 'fair value option' to measure all financial assets and financial liabilities at fair value through profit or loss.

25. By a two to one margin, the letters of comment recommended that all or most options in full IFRSs should be available to SMEs:

    a. Respondents who favoured giving SMEs the same accounting policy options generally believe that this will enhance comparability of SMEs and entities that use full IFRSs. In their view, also, prohibiting an SME from using the same accounting policies as IFRS reporters puts the SME at a disadvantage (inequitable treatment). Some respondents also noted that certain options tend to be followed in particular industries, and SMEs should have the opportunity to follow normal industry practice. If all options are available to SMEs and an SME concludes that certain options are too complex for its circumstances, it is free to choose the simpler option.

    b. Respondents who favoured reducing or eliminating options - and therefore requiring all SMEs to follow the same accounting policy for a given transaction, event, or condition – generally believe that this will result in simplified standards that will be more easily understood by SMEs. They also cited the benefits to users of the understandability and greater comparability of financial information among SMEs. They also questioned the need to compare SMEs and entities using full IFRSs.

    c. Respondents who favoured reducing or eliminating options usually favoured retaining the cost-based options (particularly with respect to property, plant and equipment; investment property; and intangible assets) and removing the revaluation/fair value alternatives.

    d. Of those who favoured reducing options, the option most singled out for elimination for SMEs was revaluation of intangibles.

    e. Around a dozen comment letter cited use by subsidiaries of full IFRS parents as one of the prime reasons for wanting all policy options available in the IFRS for SMEs. A handful more said that disclosure relief for such entities should be addressed separately, to avoid complicating requirements for other entities.

26. It should also be noted that at least one of the recognition and measurement simplifications means that not all options in full IFRSs are available in the ED: the SME ED proposes that all actuarial gains or losses be recognised immediately in profit or loss. The various other options in IAS 19 (including corridor, other allowed spreading techniques, and recognition in other comprehensive income outside of profit or loss) would not be permitted.

27. Some might find the view that SMEs should have all options in full IFRSs inconsistent with the general view in the majority of comment letters that the IFRS for SMEs should be a completely stand-alone document, with all cross-references to full IFRSs eliminated. At a minimum, the two views taken together would likely result in an increase in size of IFRS for SMEs. Moreover retention of all options was generally not the position taken by participants in the informal round-tables following issuance of the ED.

28. Respondents raised various 'version control' issues if cross-references are retained. For example, if an IAS/IFRS is amended or replaced, does that result in 'automatic' change to the cross reference, or does the cross reference to the earlier IAS/IFRS remain? Also there is an issue of where the cross-references end. For example, certain cross-referenced paragraphs, either directly or indirectly, refer to other paragraphs within IASs/IFRSs.

29. **Anticipating changes to full IFRSs (Question 11).** In at least two circumstances, the ED anticipates changes that are likely to be proposed for full IFRSs based on decisions made by the Board in current agenda projects. Those circumstances are (a) elimination of the corridor approach for deferring and spreading actuarial gains and losses and (b) elimination of certain exceptions in IAS 12 to recognition of deferred taxes. Additionally, the principle of accounting for government grants in the ED is not one of the methods currently included in IAS 20 (though any of the methods in IAS 20 can be used by an SME by cross-reference). A number of comment letters said that, as a matter of policy, the IFRS for SMEs should not anticipate possible changes to full IFRSs. Changes to full IFRSs will first have to undergo a complete and specific public due process. Only after that due process is completed should the Board consider their appropriateness for SMEs, in the view of these commentators.

30. The other Questions in the Invitation to Comment are addressed in this or other Agenda Papers for the Working Group as follows:

   a. **Recognition and measurement simplifications (Questions 2 and 3).** These are dealt with section by section below, together with other section specific issues.

   b. **Borrowing costs (Question 5), General referral to IFRSs (Question 7), and Transition to the IFRS for SMEs Question 10).** These are dealt with below under Section 24, Section 10, and Section 38, respectfully.

   c. **Adequacy of guidance (Question 8).** This is set out towards the end of this Agenda Paper starting in paragraph 81.

   d. **Disclosures (Question 9).** This is discussed in Agenda Paper 4.

Other General Issues in the Letters – Not Related to a Specific Section in the ED

31. **Name for SME.** Many comment letters agreed with the Board's description of entities that should be allowed to use the IFRS for SMEs – namely entities that do not have public accountability. Most concurred with the Board that the IASB should not establish a quantified 'size test'. However, they pointed out that use of the terms 'small' and 'medium-sized' imply a size test. Moreover, they noted that the term SME is often defined in quantified terms by local or regional laws or regulations. Therefore they recommended that the Board find a better term than SME, in particular one that better describes the scope of the Standard. Possibilities suggested include:

    a. NPAE (non-publicly accountable entity).

    b. NPIE (non-public-interest entity).

    c. Private entity (IASB generally does not use the word 'company')

32. **Scope.** Reconsider whether the IFRS for SMEs is suitable for micros, small listed entities, and some other entities that the Board believes have public accountability because they act in a fiduciary capacity such as travel agencies and unit trusts managed for a small number of investors.

    a. **Micros.** Some letters question suitability for micro entities (fewer than 10 employees) which, in most countries, are well over 95% of entities. Staff believes that the critical issue, from the viewpoint of the IASB, is whether such entities are required by law or regulation to publish general purpose financial statements (GPFS). GPFS are financial statements that are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs. The IFRS for SMEs is intended to result in GPFS on which an auditor could express an opinion regarding fair presentation (or true and fair view) of financial position, operating results, and cash flows. In publishing the ED the Board did not see a reason to prohibit micros that publish GPFS from using the IFRS for SMEs (just as it does not prohibit them from using full IFRSs). This is an issue to be resolved by legislation or regulation in each jurisdiction.

    b. **Three-tier approach.** This comment is directly related to the previous one on micros. A number of letters said that three tiers of financial reporting standards are needed: one set of standards for publicly accountable entities; a second set for non-publicly accountable entities other than micros; and a third and very simple set of standards for micros. In paragraph BC49 the Board explained why it does not plan to develop this third tier of standard and acknowledged that it is up to each jurisdiction to decide which standards should be required or permitted of different classes of entities.

    c. **Small listed entities.** Some letters question why small listed entities should be barred from the scope of the IFRS for SMEs. Most letters addressing this issue suggested that paragraph 1.3 be removed and the decision be left to individual jurisdictions. Some argued that the quality of reporting by small listed entities in some countries would be improved if they were allowed to use the IFRS for SMEs instead of their current accounting framework.

    d. **Entities that receive funds in a fiduciary capacity.** A number of letters questioned why receipt of funds in a fiduciary capacity automatically makes an entity publicly accountable. Those letters noted that regulators in most jurisdictions provide special 'prudential' protections for depositors, investors, and others for whom banks, insurance companies, brokerages, pension funds, and mutual funds hold funds. They argued that it should be left to each jurisdiction to decide whether further prudential protections should be provided by requiring full IFRSs. As examples, they questioned why small-sized security brokers, private equity houses, and trustee companies should be precluded. Those respondents recommended that the IASB limit its view of public accountability to those entities whose securities trade in a public capital market, with individual jurisdictions deciding further restrictions. Also, a number of letters recommended that the Board elaborate on the term 'fiduciary capacity', particularly how it applies in the funds industry and whether the 'fiduciary capacity' criterion refers only to an entity whose principal business is to take funds in a fiduciary capacity (rather than as a sideline, for example deposits taken by utility companies or travel agencies).

e. **Special exemptions within the IFRS for SMEs.** A number of letters suggested that the IASB should exempt entities at the small end of the SME spectrum from certain requirements of the IFRS for SMEs while retaining those requirements for entities at the larger end of the SME spectrum. An exemption from consolidation or from preparing a cash flow statement were the most frequently cited examples.

33. **Restatements.** In general, respondents favoured fewer required restatements of prior periods than now proposed, on grounds that the prior period data, if available at all, would involve undue cost or effort for many SMEs.

34. **Fair value – general.** As a general principle, restrict use of fair value to:

a. Market price is quoted or readily determinable without undue cost or effort (eg financial instruments, agriculture etc). Some respondents also thought it was necessary items were readily realisable and/or there is an intention to dispose or transfer; plus

b. All derivatives.

c. A number of letters proposed replacing the term 'fair value' with 'current value' or (if so intended) exit price or selling price. They feel that 'fair value' belongs to the language of experts and is not an easily understandable term.

35. Staff will develop a complete list of references to fair value in the IFRS for SMEs. Adoption of an 'undue cost or effort' exception would then have to be considered case by case. Comments of Working Group members are invited on this idea.

36. **Structure of the standard.** Several letters suggested restructuring of the standard. For example, add an 'SME Framework', make qualitative characteristics SME specific (plus give a hierarchy for them), emphasise stewardship, put all general measurement requirements in only one place and include in sections only specific requirements for those items (not general requirements applicable to all assets, all liabilities, all income or all expenses).

37. Staff believes that this is what the Board intended with Section 2. These commentators suggest, however, that putting all general measurement requirements in only one place will enable the IFRS for SMEs to explicitly state that "historical cost is the default measurement for all assets and liabilities unless

another measurement principle is stated". Staff notes that even full IFRSs rarely use 'historical cost' without some sort of adjustment (such as for impairment, net realisable value, amortised cost, etc.).

38. **Post-issuance assessment and ongoing reviews of the IFRS for SMEs.** A number of respondents recommended that the Board commit to a post-issuance assessment of the IFRS for SMEs. This would be more comprehensive than the general review and update planned for approximately every two years (as explained in the ED). Some respondents thought that the first update to the IFRS for SMEs could come after a shorter period (such as after one year), to address significant implementation issues. An obvious disadvantage of doing a review that soon would be that the first year of application would be a 'start up year' and many of the implementation problems are likely to be part of an education process, while those problems that continue after the second year are more likely to be more substantive issues. With regard to ongoing updates, about 25% of those who commented requested a longer regular update cycle than two years.

39. **Interpretations of the IFRS for SMEs.** The Board should either develop a formal process for considering interpretations of the IFRS for SMEs (including 'rejection notices' similar to IFRIC's) or, at least, should explain its thinking in this regard. The IASB should at least have a permanent staff dedicated to implementation of the IFRS for SMEs.

40. Staff notes that it has been the general view of the Board (reaffirmed at the Board's March 2008 meeting) that a formal process for publishing interpretations of the IFRS for SMEs is not needed. Instead, substantial guidance for implementing the IFRS for SMEs will be provided by the IASC Foundation Education Team's planned IFRS for SMEs training materials, which are expected to be released in mid- to late-2009 (see Agenda Paper 5 for this Working Group meeting). Further, the implementation guidance in full IFRSs (including Interpretations) can be used by SMEs under the hierarchy in paragraph 10.4 of the ED.

41. **Need for an IFRS for SMEs.** This was not a question in the Invitation to Comment in the ED. Nonetheless, some comment letters – particularly from several European countries – questioned the need for an IFRS for SMEs. They suggested, instead, that small entities should simply follow tax accounting requirements to avoid requiring an SME to 'keep two sets of books'. In paragraphs BC28-BC30 of the Basis for Conclusions to the ED, the Board explains its view why determination of taxable income and determination of distributable income are not specific objectives of the proposed IFRS for SMEs. The ED also explains that the decision about whether small entities should be required to prepare 'tax accounts' (which are special purpose financial statements) or 'general purpose financial statements' rests with individual jurisdictions, not with the IASB.

42. A March 2008 survey of 1,500 SMEs in six European countries by Mazars (international accounting and auditing firm based in France) found that 80% of the SMEs that responded very much favour a common accounting standard for SMEs. Of those, about half of the surveyed SMEs would make the standard mandatory, and the other half would make it optional. Perceived advantages of a common SME standard include common understanding of SMEs' accounting figures by a wide variety of users, comparability across SMEs, paperwork reduction, and

better internal communication within the entity. The surveyed companies acknowledged difficulties of a common set of standards, including learning and interpreting the standards and need for staff training. When asked who are the main users of their financial statements, the surveyed companies said bankers (80% of respondents), government and tax authorities (71%), shareholders (52%), and management (44%).

43. The Board has received considerable earlier input on the issue of whether an IFRS for SMEs is needed. For example:

    a. In September 2003, at the outset of the project, staff surveyed national standard setters about the need for simplified financial reporting standards for SMEs and whether the IASB should be the one to develop such simplified standards. Of the 30 standard setters responding, all but one said the IASB should develop such a standard.

    b. In their response to the 2004 IASCF Constitution Review, the European Commission also said the need exists and the IASB should develop an IFRS for SMEs. Similarly EFRAG's response said that development of an IFRS for SMEs should be a specific objective of the IASB.

    c. Question 1(b) in the IASB's June 2004 Discussion Paper on the approach to an IFRS for SMEs asked:

        > "Do you agree that the Board should develop a separate set of financial reporting standards suitable for SMEs? If not, why not?"

        Of the 106 comment letters that addressed this question, 93 agreed that the IASB should develop a separate IFRS for SMEs, and only 13 disagreed.

44. Some who did not question the need for an IFRS for SMEs nonetheless argued that it should have been developed using a 'fresh start' or 'bottom up' approach, rather than using the existing Conceptual Framework and existing IFRSs as the starting point. Preliminary View 6 in the IASB's June 2004 Discussion Paper explained the Board's reasoning for using existing IFRSs as the starting point. Question 6 asked:

    > "Do you agree that development of IASB Standards for SMEs should start by extracting the fundamental concepts from the Framework and the principles and related mandatory guidance from IFRSs (including Interpretations), and then making modifications deemed appropriate? If not, what approach would you follow?"

    Of the 93 comment letters that addressed this question, 76 agreed with the Board's reasons for starting with full IFRSs, and only 17 disagreed.

Issues Related to a Specific Section in the ED

45. The issues set out below in this part of this Agenda Paper do not address:

    a. **Disclosure issues.** These are addressed separately in Agenda Paper 4.

    b. **Need for additional guidance including worked examples.** These are addressed separately later in this Agenda Paper starting at paragraph 81.

46. **Use by a subsidiary of an IFRS company (Section 1).** Clarify use of IFRS for SMEs by a subsidiary of a full IFRS entity:

a. If there are recognition or measurement differences in IFRS for SMEs, can such a subsidiary use the recognition and measurement principles in full IFRSs but make only the disclosures required by IFRS for SMEs? Those who favoured this view felt it would make consolidation easier.

47. **Concepts and pervasive principles (Section 2).** Earlier in this Agenda Paper, beginning in paragraph 34, issues relating to fair value measurement were noted. Some comment letters raised similar issues with respect to Section 2. Specific issues raised include:

   a. **Financial instruments measurement.** In 2.41 (and again in Section 11) fair value should not be the default for all financial instruments. That is not the requirement of IAS 39.

   b. **Fair value (FV) measurement.** In the general principles for measurement in Section 2, clearly require measurement at cost if there is no objectively determinable or observable market price. In a similar vein, some letters would have an exception for all FV measurements when the measurement would involve 'undue cost or effort'. A number of letters would add principles for when FV is appropriate. Examples include:

      i. Those items the entity intends to dispose of and for which observable prices exist.

      ii. Assets and liabilities that are 'readily realisable'.

      iii. Where FV is 'objectively determinable' from 'observable market prices'.

      iv. Where there is an active market and the entity intends to dispose.

   c. **Stewardship.** A sizeable number of respondents suggested that, in paragraph 2.1, 'provide information about management's stewardship' should be given more importance. Other letters proposed stewardship as a separate objective of SME financial reporting on par with decision usefulness.

   d. **Qualitative characteristics.**

      i. **Hierarchy.** Add a hierarchy for 2.2 to 2.11.

      ii. **Neutrality.** Add 'neutrality' until the IASB Framework is amended.

      iii. **Full disclosure.** Add full disclosure as a qualitative characteristic.

      iv. **Faithful representation.** Add 'faithful representation' as a qualitative characteristic

      v. **Freedom from bias.** Replace 'prudence' with 'freedom from bias'.

   e. **Subsequent measurement principles.** Some letters questioned whether the pervasive subsequent measurement principles (2.41 to 2.44) are useful or whether subsequent measurement should only be discussed in individual sections of the IFRS for SMEs. (Note this contrasts with the comments highlighted in paragraphs 34-35 of this Agenda Paper, where it is noted in some letters that all general measurement requirements should be in one place and only specific requirements should be in sections). Several said that 2.41 is a description but not a principle.

f. **Subsequent measurement.** Some letters proposed adding, as a principle for subsequent measurement, that an entity should choose a measure that helps the financial statement user forecast future cash flows.

g. **Measurement.** A number of letters questioned why 2.31 only includes two possible measurement bases. They noted that the IFRS for SMEs permits or requires a number of bases other than those listed.

h. **Fair presentation.** Section 2 should describe or define what is 'fair presentation' for an SME and/or add fair presentation (some said 'true and fair presentation') of financial statements as an objective.

i. **Tax and distributable income.** Add determination of taxable income and distributable income as objectives (see BC28 to BC32).

j. **User needs.** Put more discussion of user needs in this Section. (Staff notes that that it is now discussed in BC23 to BC26.)

48. **Financial statement formats (Sections 3-8).**

a. Require a more standardised financial statement format – too many options now. Be more prescriptive of sections, subtotals, minimum line items, and sequencing in financial statements, as well as note disclosures. SMEs and less-sophisticated users will find this kind of guidance especially helpful, and a common format will enhance comparability.

b. Conform to revised IAS 1(2007), including the new requirement for a statement of comprehensive income and a single format for the statement of changes in equity.

c. Require SMEs all to use standardised titles for financial statements (paragraph 3.19 allows any that are not misleading)

d. Require two years of comparative data for SMEs, not just one (see 3.12).

e. Do not allow liquidity presentation for balance sheet (paragraph 4.5). SMEs are not able to assess relevance and reliability, as is required. Require a current/non-current presentation.

f. The current/non current distinction should be simplified by making by reference to a period of 12 months. Some items (such as pension obligations) should always be classified as non-current liabilities.

g. Require analysis of expenses by nature for all SMEs, for comparability and usefulness (see 5.8). Function is somewhat arbitrary and not comparable from company to company. If choice is retained, do not require disclosure of additional information if function is chosen.

h. Require separate presentation of changes in fair values on the face of the income statement (if they are recognised in profit or loss).

i. Do not allow a combined statement of income and retained earnings (see paragraph 6.4). Staff comment: This comment was made by a significant number of respondents, but reasons given were not very strong, for example reasons included may lead to a lack of comparability and should not introduce a new statement which is not in full IFRSs.

j. Do not require a statement of changes in equity (Section 6). Require appropriate information in note disclosure. Also, if required, clarify or illustrate what this statement would look like for unincorporated entities.

49. **Statement of cash flows (Section 7).**

    a. Remove the direct method for reporting operating cash flows (it is now a cross-referenced option).

    b. Exempt either all SMEs or small SMEs from the requirement to prepare a statement of cash flows, or allow jurisdictions to decide which entities are exempt from such a requirement under the IFRS for SMEs.

    c. Require that all cash flows from income taxes be operating.

50. **Disclosures (Section 8).** As noted earlier, disclosure issues raised by respondents are discussed in Agenda Paper 4.

51. **Consolidation (Section 9).**

    a. Exempt smaller entities from the requirement to prepare consolidated financial statements, or allow jurisdictions to decide who prepares consolidated financial statements under the IFRS for SMEs.

    b. Or possibly establish criteria when consolidation should be required. Examples of such criteria might be:

        - Joint management.
        - Substantial intercompany transactions.
        - Borrowings of one entity secured by assets of the other.

    c. Allow a temporary control exemption from consolidation.

    d. Only allow non preparation of consolidated financial statements under 9.2 if the minority interest does not object.

    e. Do not have requirements for combined financial statements. This is not a concept that is specific to SMEs, and it should be developed in full IFRSs first. Alternatively, some respondents suggested requirements for combined financial statements should be removed unless further guidance is provided (this is further expanded on in the Adequacy of Guidance part of this Agenda Paper starting in paragraph 81).

52. **Separate financial statements (Section 9).**

    a. Allow different accounting policies for categories of investments (for instance, one policy in accounting for associates in separate financial statements and a different policy in accounting for subsidiaries).

    b. Allow equity and proportionate consolidation methods in separate financial statements – not only cost or fair value through profit or loss. That is, mirror treatment in consolidated financial statements to save time and explanations.

    c. If an active market exists, require fair value through profit or loss for investments in subsidiaries in separate financial statements.

    d. Preparing consolidated financial statements should not exempt entities from separate financial statements (that is, IFRS for SMEs should require both).

e. Allow separate company SME financial statements without requiring consolidation even if the parent does not meet paragraph 9.2(b) (re ultimate parent producing IFRS consolidated financial statements).

Accounting Policies Hierarchy (Section 10) – Question 7 in the Invitation to Comment

53. Of those who responded to Question 7, approximately three-quarters supported the hierarchy proposed in paragraphs 10.2 to 10.4, although some of those respondents proposed slight amendments to clarify the requirements of these paragraphs. (Note, this is specifically concerning the hierarchy. Views on the use of cross-references are captured earlier in this Agenda Paper). Nearly all the suggested amendments related to the need to state explicitly that there is no obligation to look back to full IFRSs. Comments include:

   a. Amend 10.4 to clarify that full IFRSs and pronouncements from other standard setting bodies can be considered 'to the extent they do not conflict with the sources in 10.3'.

   b. Revise 10.4 by replacing phrase 'may also consider' with 'is not required, but may wish to consider'.

   c. Revise the second sentence of 10.4 to commence 'If further additional guidance' to clarify it is not a mandatory fallback.

   d. Delete the reference to full IFRSs in 10.4.

   e. Eliminate 10.4 and simply mention full IFRSs as one source of appropriate guidance together with other GAAPs and accounting literature. 10.4 seems to introduce a hierarchy where SMEs must look first to full IFRSs and, only if additional guidance is needed, to other GAAP. Those who support this approach believe that this hierarchy may distract from properly applying 10.2 and 10.3 and cause the risk full IFRSs will be considered more than intended.

   f. Some respondents proposed explicit clarification that an entity should give preference to full IFRSs over pronouncements of other standard setting bodies.

54. A few respondents would go further than just changing the wording in the hierarchy. They rejected the hierarchy altogether, as they felt that 10.2-10.4, plus the numerous cross-references to full IFRSs and the close relation between full IFRSs and IFRS for SMEs, together constitute a de facto obligation to take recourse to full IFRSs.

55. In contrast, many of the remaining one-fourth of respondents who expressed reservations about the hierarchy did so because they felt that full IFRSs should be given more emphasis.

   a. Half of this group felt that if IFRS for SMEs does not specifically address a transaction, but full IFRSs does, then the entity should be required to look back to full IFRSs (in priority to applying 10.3). Some felt a fallback should always be required when specific detailed guidance for a particular type of transaction was missing; however others felt a fallback was necessary only if the IFRS for SMEs did not specifically address a particular transaction at all. This means that such respondents did not feel that SME-specific solutions derived from the concepts and principles in Section 2, or by analogy to similar issues addressed in IFRS for SMEs, should be allowed where there are specific requirements in full IFRSs. The effect of this approach would be to require SMEs to be knowledgeable about both the IFRS for SMEs and full IFRSs. The IFRS for SMEs would become simply guidance for an SME in applying IFRSs.

b. In addition, several other respondents said that while there should not be a mandatory fallback to full IFRSs, full IFRSs should be given priority over recent pronouncements of other standard-setting bodies. That is, full IFRSs should not be given priority over 10.3, but should be given priority in 10.4. This is different from a mandatory fallback to full IFRSs, as it still allows SME-specific solutions to be derived based on the concepts and principles in Section 2 or by analogy to similar issues addressed in the IFRS for SMEs.

56. **Other issues for Section 10:**

a. When an SME is following an option in a full IFRS, and that full IFRS changes, do not require SMEs automatically to follow the transitional provisions in that revised IFRS.

b. Require retrospective restatement (correction) only for 'fundamental' errors (some letters said 'material' errors).

c. Do not require retrospective restatement for a voluntary change in accounting policy or for an error. SMEs do not have the data or the resources to do the retrospective restatements.

d. Regarding retrospective restatement, some letters would also not require SMEs to restate for accounting changes mandated by changes to the IFRS for SMEs, for the same reason as in b above.

57. **Financial instruments (Section 11):**

a. Make cost the default measurement basis, not fair value. (See paragraphs 34-35 of this Agenda Paper regarding comments for limiting use of fair value).

b. Bring back the available for sale category.

c. Straight-line amortisation of discounts/premiums, not the effective interest method.

d. Hedge accounting:

- Allow a shortcut method for hedging by which, if certain conditions are met, effectiveness could be presumed without a complex calculation.
- Guidance for measuring hedge effectiveness should be within Section 11, not in the Basis for Conclusions.
- Simplify hedging documentation.

e. Allow purchased options and debt instruments as hedging instruments.

f. Clarify what is required for derivatives and embedded derivatives. Respondents noted that the scope requirements for leases and insurance contracts 11.3(c) and 11.3(e) and non-financial items (11.4) are confusing. Section 11 would require that the full host contract be measured at fair value if there is an embedded derivative.

g. Add guidance on factoring and similar transactions.

h. Do not allow the choice of using full IAS 39. Respondents who held this view generally were opposed to allowing any accounting policy options in the IFRS for SMEs. Also, some said that IAS 39 is too complex or too costly for SMEs to apply, and that allowing its use would reduce comparability among SMEs.

i. In particular for Section 11, respondents requested that the language should be simplified, the structure improved, and requirements should be made explicit, not implicit (for example, for derivatives).

58. **Inventories (Section 12):**

a. Allow SMEs to measure all of their inventory at the most recent prices.

b. Allow LIFO as an inventory costing method.

c. Do not require non-production overheads in inventories. 12.10 says "it may be appropriate".

d. Replace Section 12 with IAS 2 in full, as IAS 2 is short and easy to apply.

59. **Associates and joint ventures (Section 13 and 14).** The most common comment relating to these two sections is that the proposed IFRS for SMEs permits too many options in accounting for associates and JVs. There were various proposals for reducing or changing the options now in Sections 13 and 14: [Note that the SME ED was developed before ED 9 on JVs and commentators may not have taken ED 9 into account. ED 9 would, among other things, would recognise an interest in a joint venture using the equity method. Proportionate consolidation would not be permitted.]

a. Some respondents rejected cost method for significant associates and joint ventures.

b. Some respondents would not allow fair value through profit or loss.

c. Some letters recommended that the IASB simplify the equity method and proportionate consolidation methods rather than adding options.

d. Some would have the equity method as the default with the cost method the alternative if information is not available to apply the equity method.

e. Allow separate policy choice for non-publicly traded investments.

f. Allow SMEs a greater time lag for associate's info when applying equity method.

60. Other proposals made in the comment letters:

a. Develop a hierarchy of which method is most appropriate, for example based on availability of information to determine fair values or to apply equity accounting, rather than pure accounting policy options.

b. Several letters proposed to delete the concepts of associates and jointly-controlled entities. Presumably, then, they would be covered by Section 11 (Financial Instruments), from which they are now exempted by 11.3(a).

61. **Investment property (Section 15).** Recommendations in the comment letters were:

a. Allow fair value model, but changes in fair value should go to equity.

b. Allow an option not to separate lease of land and buildings if classified as investment property and use the fair value through profit or loss model.

c. Do not allow the fair value model for reasons of complexity and lack of comparability.

d. IFRS for SMEs should have a single revaluation model for all non-financial assets, not different methods for property, plant and equipment and investment property.

e. Remove the option to classify property held under an operating lease as investment property.

62. **Property, plant and equipment (Section 16).**

a. Do not require component depreciation for SMEs, or make clear that it is optional.

b. Do not require annual review of residual value, useful life, and depreciation method, or reassess only if there is a clear indication of change.

c. Do not allow SMEs to revalue PP&E (that is, remove this option).

d. Add undue cost exemption for separation of land and buildings.

63. **Intangible assets other than goodwill (Section 17).**

a. SMEs should not be required to distinguish between intangible assets with finite and indefinite useful lives (that is, amortise all intangibles).

b. Some comment letters said capitalisation of internally generated intangible assets should not be allowed. Others said the capitalisation model should be required.

c. Do not require annual review of amortisation period and amortisation method, or reassess only if there is a clear indication of change.

d. Do not allow SMEs to revalue any intangibles, that is, remove this option.

64. **Goodwill (Section 18) and intangibles (Section 17) amortisation.** Permit or require amortisation of goodwill and other indefinite life intangibles over a limited number of years. Respondents generally acknowledged that there still would be a need to consider impairment. However, they pointed out that, over time, amortisation would lessen the need for an impairment write-down.

65. **Business combinations (Section 18)**. Simplify allocation of cost. In particular

a. Do not require separation of all or certain intangibles (such as those with no quoted market price, those that are not legal rights, and those that were not recognised by acquiree).

b. Do not require recognition of contingent liabilities.

c. Simplify requirements for initial accounting, for instance by prospective rather than retrospective adjustments, longer period for determination.

d. Also a few comment letters suggested that use of book values/pooling of interests method should be considered. This was predominantly mentioned in relation to cooperatives, where it is felt that the purchase method ‘is not appropriate’.

66. **Leases (Section 19).**

a. Do not require the straight-line method for operating leases (spreading total lease payments evenly over the lease term).

b. Do not require a finance lease to be measured only at fair value of leased property. Two methods were proposed: either reinstate lower of FV and present value of minimum lease payments or just require present value of minimum lease payments. In the later case, some letters noted impairment requirements would prevent overstatement of assets.

c. Do not require separation of land and buildings (or perhaps have an undue cost or effort exemption).

d. Treat all leases as operating leases.

e. Simplify classification criteria, for example, use fewer criteria or introduce quantitative tests.

67. **Provisions (Section 20).** Simplify measurement requirements, for example, simplify probability estimates and discounting (such as by using the average company borrowing rate).

68. **Debt - equity classification (Section 21).** Simplify the requirements for split accounting (or do not require it at all) and classification as equity or liabilities. Consider the different legal forms of entities within the scope of IFRS for SMEs. Various suggestions were made. Note: these comments were made before the IASB's final changes to IAS 32 were adopted for classification of puttable instruments and obligations arising on liquidation. As a result of the amendments, some financial instruments that had met the definition of a financial liability will be classified as equity because they represent the residual interest in the net assets of the entity. The amendments have detailed criteria for identifying such instruments, but they generally would include:

- Puttable instruments that are subordinate to all other classes of instruments and that entitle the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

- Instruments, or components of instruments, that are subordinate to all other classes of instruments and that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.

69. **Borrowing costs (Section 24) – Question 5 of Invitation to Comment.** Approximately 75% of the letters responding to the specific question in the Invitation for Comment supported retention of both methods of accounting for borrowing costs. Approximately 15% of the letters supported capitalisation only. A few letters suggested possible simplifications to the capitalisation method under full IFRSs, the most popular being compute all capitalisation on the basis of average borrowing cost (do not require tracing of specific borrowings).

70. **Share-based payment (Section 25).** Simplify – intrinsic value is not much of a simplification. Possible simplifications include intrinsic value measured only at

issuance (not updated) or FAS 123 calculated value method (again no subsequent 'true up'). Also, consider disclosure only for equity-settled share-based payments.

71. **Impairment (Section 26):**

   a. Allow or require consideration of value in use or a simplified value-in-use calculation that uses information easily available to a small entity - for example allowing entities to use their own incremental borrowing rate and their own budgets for cash flow forecasts. Currently, the ED requires only fair value measurement.

   b. Require that the future use of the asset be considered in determining whether to use fair value (expected sale) or value in use (continued use in business).

   c. Simplify requirements for impairment of goodwill (various issues were raised).

   d. Bring back cash generating units if the recoverable amount of individual assets cannot be determined.

72. **Pensions (Section 27).** Simplify defined benefit pension plan accounting:

   a. Allow other options for actuarial gains and losses, in particular recognition outside profit or loss, such as in equity or in other comprehensive income.

   b. Allow deferral and amortisation of past service costs.

   c. Do not require a specific actuarial method (projected unit credit). Also clarify that even if a specific method is required, an actuarial valuation performed by an outside actuary is not required to be done every year. Also clarify that updating prior period valuations for changes in circumstances can result in reasonable measurements.

   d. Measure as if all employees would retire as of the reporting date (that is, at current liquidation amount).

   e. Treat all multiemployer plans as defined contribution.

73. **Income taxes (Section 28).** Many comment letters recommended simplifying the requirements for income taxes, but there was no clear consensus of the best way to do that. Suggestions included:

   a. Taxes payable method (no deferred tax recognised), with some disclosure about 'deferrals'.

   b. Taxes payable method plus accrual of those deferred taxes that are expected to reverse in a short period (say two or three years).

   c. Timing difference method.

   d. Timing difference method plus accrual of deferred taxes relating to book/tax basis differences that were recognised directly in other comprehensive income.

   e. Do not recognise deferred tax assets, or limit the time period for assessing whether there will be sufficient future taxable profit for recovery, to avoid ongoing calculations.

   f. Do not require tax consequences of transactions to be attributed to discontinued operations or equity as this is complex.

74. **Financial Reporting in Hyperinflationary Economies (Section 29).** A few letters noted that normally existence of hyperinflation is decided on a country-

wide basis for consistency and so the criteria for assessing if an economy is hyperinflationary should be the same as IAS 29, rather than just having the numerical test that cumulative inflation over 3 years should approach or exceed 100%.

75. **Foreign currency translation (Section 30)**.

    a. Where the law requires that financial statements must be presented in the national currency, allow that to be used as the functional currency.

    b. Do not require, or possibly even prohibit, recognition of cumulative exchange differences in profit or loss on disposal of a foreign operation, to avoid the administrative burden of tracking historical exchange rates.

76. **Segment reporting (Section 31), earnings per share (Section 34), and interim reporting (Section 37)**. A few comment letters agreed that if entities wanted to provide such information then they should be required to follow full IFRSs. A few other letters noted that full IFRSs should not be required, but simplified optional requirements should be included in IFRS for SMEs. However, the majority of respondents suggested removing these section entirely, recommending that entities should be able to present voluntary information without having to apply the full IFRS. The hierarchy in Section 10 would then govern, but clear disclosure of the basis of presentation used should be required.

77. **Related parties (Section 33).** Do not require disclosure of sensitive information or information that could cause competitive disadvantage. Main example given is disclosure of key management personnel (KMP) compensation if entity only has one or two members of KMP. A few respondents mentioned that Section 33 should be amended for the requirements in the Exposure Draft of Amendments to IAS 24 if that amendment is finalised before the IFRS for SMEs is issued.

78. **Agriculture (Section 35).** Respondents recommended greater use of cost, for example, by allowing the cost method as an accounting policy choice or by requiring fair value only in certain circumstances. Use of fair value is addressed generally in paragraphs 34-35 above.

79. **Assets held for sale and discontinued operations (Section 36).**

    a. Remove the held for sale classification, or require note disclosure only. A few respondents said requirements could be briefly addressed within relevant sections, for example in Section 16 for property, plant and equipment. Others said that an asset is held for sale could just be treated as an impairment indicator under Section 26.

    b. Simplify (or even eliminate) discontinued operation disclosures and restatements.

80. **First-time adoption of the IFRS for SMEs (Section 38) – Question 10 of Invitation to Comment.** The majority of respondents were happy with the approach in Section 38. However, a significant number of these suggested modifications, including the following:

    a. Include all of the IFRS 1 optional exemptions for first time adopters (for example, parent and subsidiary adopt at different times, and deemed cost for investment property and intangibles).

b. Relax the use of ‘impracticable’ – that is, provide an exemption from restatement at a far lower hurdle than the ‘impracticable’ exemption in full IFRSs.

c. Relax requirements for moving to and from full IFRSs (maybe more than once). On the other hand, a number of respondents were concerned about entities switching between the IFRS for SMEs and full IFRSs many times and felt there should be some kind of restriction or grace period. Some said that this may be a matter left to each jurisdiction to decide.

Adequacy of Guidance

81. 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 (both examples and narrative guidance) that is in full IFRSs is not included. In Question 8 of the Invitation to Comment, the ED asked respondents to identify specific areas for which SMEs are likely to need additional guidance.

82. Respondents recommended that additional worked examples or narrative guidance be added in a number of areas. Presented below are the recommendations that were either repeated by more than a few comment letters or were rarely mentioned but that staff judged should be listed due to their nature. The relevant section number in the ED is shown in parentheses. Respondents did not generally indicate whether they thought the additional worked examples should be provided in the IFRS for SMEs, in accompanying Implementation Guidance, or in a supplementary fashion such as through the planned IASCF Training Materials (most respondents would not have been aware of these planned Training Materials). Working Group members are asked to consider (a) whether they think the recommended guidance set out below would be useful to a broad segment of SMEs and (b) if so, how the IASB should provide it.

- (7) In the Implementation Guidance (illustrative financial statements) there should be an example of a cash flow statement where cash flows from operating activities are reported using the direct method.
- (7) Add guidance on reporting cash flows when using equity method or proportionate consolidation for investments in associates and joint ventures (IAS 7.37-38).
- (7) Add guidance on reporting cash flows for acquisitions and disposals of subsidiaries/business units (IAS 7.39-42).
- (8) To improve clarity, give examples suited to SMEs illustrating information about judgements (paragraph 8.6) and key sources of estimation uncertainty (paragraph 8.7).
- (9) Examples on consolidation procedures should be included in the implementation guidance.”
- (9) The illustrative financial statements comprise a parent entity and its wholly-owned subsidiary (per accounting policy notes). It would be more helpful if the subsidiary was not wholly-owned. This would then require

minority interest disclosures in both the consolidated statement of income and retained earnings and consolidated balance sheet.

- (9) Paragraph 9.21 – Clearer instructions as to how to prepare combined financial statements are needed. Issues include scope and definition of combination relationships (e.g. family relationships, existence of agreements, common management etc), rules for determining equity and minority interest, and measurement principles for combined assets and liabilities and differences with consolidated financial statements. Include an illustrative set of combined financial statements.
- (9) Add guidance on how potential voting rights affect control assessment (currently the ED only addresses allocation of profits when potential voting rights exist).
- (9) Add guidance on circumstances when special purpose entities exist.
- (9) Add a description of the cost method.
- (10) Add an example to illustrate changes in accounting estimates, eg how a change in estimated useful life of a depreciable asset is accounted for.
- (11) Add guidance on accounting for initial transaction costs on acquisition
- (11) For financial instruments add examples of computation of amortized cost and effective interest rate.
- (11) Simple illustrative examples for hedge accounting would be useful for preparers. Foreign exchange hedging to support a transaction (paragraph 11.37 and 11.39) and interest rate swaps are arguably most common scenarios.
- (11) Add guidance on determination of hedge effectiveness (currently there is some guidance in the Basis for Conclusions).
- (11) Add guidance on accounting for financial guarantees.
- (11) Purchase and sale contracts for non-financial items, especially commodity contracts, require further guidance.
- (11) Add guidance regarding approach to accounting for embedded derivatives.
- (11) Purchase and sale contracts for non-financial items, especially commodity contracts, require further guidance.
- (11/35) Guidance on accounting for insurance contracts from a policy holder's point of view.
- (12) Explain the retail inventory method (12.15), suggest adding IAS 2.22.
- (15) Include examples on accounting for various costs incurred in relation to investment property and accounting for impairment or losses of such property.
- (16) Add guidance on subsequent coats, as Section 16 has guidance only on initial costs.
- (18) Add simplified version of Illustrative Examples from IFRS 3 for intangibles acquired in business combination that were not previously recognised by acquiree.

- (18) Add an example to illustrate a reverse acquisition. IFRS 3 Illustrative example IE 5.
- (18) Include examples for step acquisitions.
- (18) Group reorganisations are not dealt with but they are quite common for SMEs. They are much more frequent than discontinuation of activities. Provide specific requirements or at least guidelines on the appropriate treatment.
- (18) Guidance on initial accounting determined provisionally.
- (18) Add guidance on the appropriate treatment for the acquisition of entities or groups of assets that are not businesses (from IFRS 3.4) – for example, purchase of all the net assets of another entity (18.2) is not always a business combination.
- (19) Illustrate calculations for finance and operating leases, from perspective of both lessee and lessor.
- (19) Add accounting requirements for operating lease incentives.
- (19) Add guidance on the accounting treatment for contingent rents under operating leases.
- (19) Add guidance on classification of leases of land and buildings and allocation of lease payments between the two elements.
- (20) Add guidance from IAS 37.80-81 on restructuring provision costs.
- (20) Add examples of contingent assets to expand 20.13.
- (20) Add guidance on treatment of executory contracts and guidance on recognition for terminal losses concerning long-term contracts. This will increase clarity of Section 20.
- (20) Add guidance on best estimate of amount required to settle obligation (20.8).
- (21) Add guidance on accounting for equity interests in partnerships and co-operatives.
- (21) Add clear guidance on distinguishing between debt and equity. For example, guidance on high/low redeemable preference shares (are they equity or liability). In Canada, such shares are commonly issued in estate freeze arrangements in private companies for tax reasons.
- (22) Provide examples for agency relationships (22.4) and to illustrate deferred payments.
- (22) Add guidance on revenue recognition for multiple-element transactions should be provided.
- (22) Add guidance on revenue recognition for construction contracts. Clarify terms “contract revenue” and “contract costs” to reduce diversity in practice.
- (23) Add guidance for loans at nil or low interest rates (government grants).
- (25) Add an example to illustrate application of 25.7 re share-based payment (SBP) transactions with cash alternatives.

- (25) Add guidance on group transactions (IFRIC 11) in appendix as many entities have employees in group SBP arrangements. Scope of Section 25 should be amended to allow for IFRIC 11.
- (25) Section 25 refers only to SBPs made by the entity. IFRS 2.3 includes transfer of entity's equity instruments by its shareholders or by its parent or by another group entity in the scope. Guidance should be added.
- (25) Provide examples on SBP transactions to minimise confusion.
- (26) Include examples on the two step process for goodwill impairment tests
- (26) Add examples to illustrate impairment of non-financial assets,
- (26) Include guidance and examples on how to follow the two step process for goodwill impairment tests. It is not clear how this is applied in practice.
- (27) For employee benefits, add illustrations of simplified actuarial computations in an appendix to Section 27. SMEs would normally find periodic actuarial valuations costly. Explain how to calculate the defined benefit obligation using specific amounts for an entity with 50 employees.
- (27) Add requirements for group defined benefit plans.
- (28) Add examples to illustrate deferred tax calculation and preparation of the tax rate reconciliation.
- (28) Add the rest of the examples from IAS 12.7and 12.8 (some already in Section 28) to explain why timing differences in 28.7 and 27.8 are temporary differences.
- (28) Examples should be given for tax bases of liabilities as well as assets.
- (28) If IASB does not allow initial recognition exemption (see Section 28 comments), 28.17 should be supplemented by worked examples, as calculations will be unfamiliar to SMEs (and even users of full IFRSs).   "
- (28) Include more examples (like in IAS 12). Section 28 is clearer than IAS 12, but users may not understand the requirements without more examples.
- (28 and IG) There is no mention of deferred tax relating to depreciation in Note 12 of the Implementation Guidance (IG). The deferred tax note should refer to temporary differences resulting from different rates of depreciation for tax and financial reporting purposes. This is one of the more common temporary differences for SMEs."
- (30) Add examples to illustrate accounting for importing and exporting activities.
- (30) In 30.11, include examples of non-monetary items that could produce a gain or loss that is recognised directly in equity.
- (30) Add paragraph similar to IAS 21.12 to indicate hierarchy for considering indicators of functional currency.
- (32) Clarify "date when financial statements are authorised for issue" by adding the examples in IAS 10.5 and IAS 10.6 in section 32, or similar examples suited to SMEs.

- (33) Add an explanation of what is meant by the key concept of the ‘amount of the [related party] transactions’ in 33.8(a).
- (35) Include specific guidance on how entities should value offspring of biological assets. As no cost is available, we propose offspring is valued at fair value.
- (36) Include examples of the disclosures that must be made both with regard to the income statement as well as the notes to the financial statements for discontinued operations.
- (36) 36.4 covers reclassification of discontinued ops in income statement if item is no longer held for sale, but gives no guidance on remeasuring asset. Add IFRS 5.27.
- (36) Add more guidance for classification and measurement of held for sale items from IFRS 5.16-29.
- (38) 38.11(a) and (b) might benefit from an illustrative example with dates (particularly as ‘date of transition’ is not defined anywhere).
- (38) Add illustrative examples for capitalisation of development costs.
- (38) Suggest including in Basis of Conclusions an explanation on why an entity would be a first-time adopter when moving from full IFRSs to IFRS for SMEs.
- (38) Clarify use of ‘undue cost or effort’ exemption regarding comparative period deferred tax balances on transition to IFRS for SMEs.
- (IG) Cash flow statement should illustrate acquisition or disposal of subsidiaries.
- (IG) Give an illustrative example of a statement of changes in equity - also illustrate paragraph 6.3(c) [reconciliations of classes of equity] as it is unclear what is required.
- (IG) The inclusion of illustrative financial statements for service, commercial, and manufacturing entities would be helpful to SMEs.
- (Basis for Conclusions) The Basis for Conclusions should set out a sound rationale for the approach taken in the ED and not be only targeted towards readers familiar with full IFRSs. It currently does not explain how differences between circumstances of SMEs and those of publicly accountable entities (BC21) are expected to affect financial reporting by SMEs or how the IASB balanced users’ needs against cost-benefits and practicability.
- (Various sections) Include a paragraph on scope at the beginning of each section, explaining which transactions will be addressed.
- (Various sections) Examples re discounting, for example, for financial and non-financial assets /liabilities, leasing contracts, etc.
- (Various) Explain when fair value can be readily determinable without undue cost or effort by, for example, indicating when the inputs need to incorporate observable market values or a professional valuation or a reasoned estimate by management. Guidance on use of term ‘undue cost or effort’ is also required. Consistent with our proposal on Section 11, consideration should be given in

other sections to the use of FV if it is readily determinable without undue cost or effort.

- (Interpretations) BC66 implies interpretations were factored into ED, but many do not appear to have been. Their status should be clarified, for example, say why some have been included and others not. Specifically, IFRIC 1, IFRIC 4, IFRIC 8, IFRIC 12, SIC 10, SIC 12, SIC 15, and SIC 29 are relevant to SMEs and should be included.

83. Respondents recommended many more items of additional detailed guidance than those above. Staff has captured those in a comprehensive list that it will consider in redrafting the ED.

Adequacy of Disclosures

84. 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*. The ED asked for views on whether any of the proposed disclosures should not be required for SMEs, and why. And, conversely, the ED asked for views on whether there are disclosures that are not proposed that the Board should require for SMEs, and why.

85. Many letters of comment encouraged the Board to make further disclosure simplifications. A few also proposed additional disclosures. We have summarised both categories separately in Agenda Paper 4 for the Working Group meeting.

Preliminary Work Plan for Completion of the Project

Board Meetings

86. **March 2008 –** SME project was on the agenda for a two-hour, educational session relating to issues raised in the comment letters on the ED. *IASB Update* for March 2008 has a summary of the discussion.

87. **April 2008 –** SME project is on the agenda for a one hour educational session.

    - Objective is a detailed report to Board on issues arising from field tests. Board discussion to clarify those issues.
    - Agenda Paper 1 will be report on the field tests. Working documents, such as spreadsheets, supporting the report will be provided to Board members.

88. **May 2008 –** SME project on agenda three hours, for decisions.

    - Objective is Board decisions on how issues arising from comment letters and field tests should be resolved. This will be continued in June and July.
    - Agenda Paper 1 will be a list of all substantive issues resulting from comment letters and field tests with pros and cons and staff recommendations. This list will be prioritised in the sequence in which we need Board decisions.
    - Agenda Paper 2 will be report of the 10-11 April meeting of the Working Group (see below).

- Seek Board decisions on technical issues. In May (this month) decisions will be requested on the highest priority issues. Discussion and decisions will continue in June and July 2008 on other issues.

89. **June 2008 –** SME project on agenda three hours, for decisions.

    - Objective is Board decisions on how issues arising from comment letters and field tests should be resolved. This will be continued in July.
    - Agenda Paper 1 will be an update of Agenda Paper 1 for May 2008 meeting plus a new cover note. Continue to discuss and get Board decisions on substantive issues.

90. **July 2008 –** SME project on agenda three hours, for decisions.

    - Objective is Board decisions on how remaining issues arising from comment letters and field tests should be resolved.
    - Agenda Paper 1 will be an update of Agenda Paper 1 for May 2008 meeting plus a new cover note. Continue to discuss and get Board decisions on substantive issues.
    - Goal is to have all substantive decisions on individual issues completed by July meeting.

91. **September 2008 –** Staff send to the Board a comprehensive draft of a final IFRS for SMEs (revised ED reflecting the technical decisions at the May, June, and July 2008 meetings). Seek written comments from Board members that identify those issues with which a Board member has a significant disagreement. Those issues will then be brought to the Board in October and at subsequent meetings to the extent necessary (‘sweep issues’).

92. **October 2008 –** SME project on agenda three hours for review of the outstanding issues in the comprehensive draft of a final IFRS for SMEs.

    - Objective: Get Board decisions on ‘sweep issues’.
    - Agenda Paper 1 will be a complete revised marked draft of the ED reflecting all previous decisions.
    - Agenda Paper 2 will be a summary of the ‘sweep issues’ and staff recommendations for resolution.

93. **November 2008 –** Continue with sweep issues from October, as needed.

94. **December 2008 –** Continue with sweep issues from November, as needed. If none, a preballot draft will be sent to the Board for written comments, and possibly a ballot draft.

Attachment A: Cross-references to full IFRSs in the ED

#	Para	IFRS	Description of Cross Reference	BC para
Accounting Policy Options				
1	7.9	IAS 7	Option to use direct method for cash flows from operating activities under IAS 7	114
2	11.1	IAS 39 and IFRS 7	Option to follow IAS 39 in full for financial instruments and hence must also follow disclosures in IFRS 7 (also definition of hedging instrument refers back to IAS 39)	78
3	13.5	IAS 28	Option to follow equity method and disclosures for associates under IAS 28	83
4	14.10	IAS 28 and IAS 31	Option to follow equity method and disclosures for jointly controlled entities under IAS 28 (via IAS 31)	83
5	14.11	IAS 31	Option to follow proportionate consolidation method and disclosures for jointly controlled entities under IAS 31	83
6	15.5	IAS 40	Option to follow fair value model and disclosures for investment property under IAS 40	110
7	16.13	IAS 16	Option to follow revaluation model and disclosures for PPE under IAS 16	111
8	17.16	IAS 38	Option to follow capitalisation model for research and development under IAS 38	82
9	17.23	IAS 38	Option to follow revaluation model and disclosures for intangible assets under IAS 38	112
10	23.3	IAS 20	Option to use IAS 20 for grants that are not related to assets measured at fair value through profit or loss.	115
11	24.4, 24.5	IAS 23	Option to use capitalisation model and disclosures for borrowing costs under IAS 23	113
12	12.10	IAS 23	Including borrowing costs in inventory (for an entity that chooses the capitalisation model)	n/a

Attachment A continued on next page...

Attachment A, continued

Omitted Guidance				
13	19.15	IAS 17	Omitted guidance - lessor in a finance lease refers to guidance and disclosures under IAS 17	62
14	25.4	IFRS 2	Omitted guidance - for equity settled share based payments refer to measurement and disclosures under IFRS 2.	59
15	25.7	IFRS 2	Omitted guidance - for share based payment transactions with cash alternatives refer to guidance under IFRS 2.	n/a
16	29.2, 29.3, 30.21	IAS 29	Omitted guidance - entities whose functional currency is hyperinflationary follow IAS 29 in full and related part of IAS 21.	58
17	31.1	IFRS 8	Omitted guidance - entities wishing to produce segment information refer to IFRS 8.	64
18	34.1	IAS 33	Omitted guidance - entities wishing to produce earnings per share refer to IAS 33	63
19	35.1(a)	IAS 41	Omitted guidance - entities with biological asses whose fair value is readily determinable without due cost or effort apply fair value model and give disclosures under IAS 41.	60
20	35.3	(IFRS 4)*	Omitted guidance - entities who are insurers are outside scope of IFRS for SMEs	65
21	37.1, 37.2	IAS 34	Omitted guidance – entities wishing to prepare interim reports that conform to the IFRS for SMEs must follow IAS 34	61
Other				
22	10.4	full IFRSs	Reference to full IFRSs dealing with similar and related issues in the hierarchy	56(c)
23	Defini-tions	IAS 28 and IAS 31	Related party definition	
24	Defini-tions	IAS 39	Hedging instrument definition	

*Does not actually make an explicit reference to IFRS 4.

Numerous mentions of full IFRSs in the Preface.

Full IFRSs are also mentioned in 38.1 and 38.2 as a possible previous GAAP pre transition to IFRS for SMEs.

IFRSs are naturally mentioned in the definitions of ‘first time adopter of IFRS for SMEs’, ‘full IFRSs’ and ‘International Financial Reporting Standards’.