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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Project:	**IFRS for Small and Medium-sized Entities**
Meeting:	**SME Working Group, 10-11 April 2008, London**
Paper:	**Summary of Issues Raised in the Field Tests (Agenda Paper 2)**

Objective of this Agenda Paper

1. This Agenda Paper 2 for the 10-11 April 2008 SME Working Group (WG) meeting highlights the main issues that have been identified as a result of the programme for field testing the Exposure Draft (ED) of the proposed IFRS for SMEs. This paper complements Agenda Paper 1, which highlights the main issues issued in the comment letters on the ED.
2. Both sets of issues are combined in Agenda Paper 3 to make the Working Group discussion easier. <u>Agenda Paper 3 will not introduce any new issues.</u> A substantial portion of the two day meeting of the WG will be devoted to discussion of the issues in Agenda Paper 3. A report of the views of the WG members will be provided to the Board as input to the Board's redeliberations of the Exposure Draft, which will begin in May 2008.

Background on Field Testing of the ED

3. Subsequent to issuing the ED, the staff organised a programme to field test it. The goals of the field testing were:
   - **to assess understandability.** Identify parts of the ED that field test entities found hard to understand.

- **to assess scope.** Identify transactions, events or conditions that the field test entity encountered, but that are not covered in the ED, and find out how the field test entity made its accounting policy decision, including whether the entity looked to full IFRSs as a reference.
- **to assess burden.** Assess the burden of applying the ED, for instance, whether information required to apply it was not available or available only with undue cost or effort.
- **to assess impact.** Assess the nature and degree of changes from the field test entity's current GAAP or current reporting practices.
- **to assess accounting policy choices.** Where an accounting policy choice is allowed in the ED, to identify any circumstances in which the field test entity chose to use an accounting policy option in a full IFRS, and why.
- **to assess micro and developing country problems.** Identify any special problems in applying the ED that arise for field test entities that are so-called 'micro entities' (those with fewer than 10 employees) and for field test entities in developing economies.
- **to assess the adequacy of implementation guidance.** Identify where additional implementation guidance would be helpful to the field test entity.

4. We developed a field test questionnaire that was posted on the IASB's website in June 2007 in English, Spanish, and French. Professional accounting bodies and accounting standard-setters in nearly 20 jurisdictions, and several international organisations, took the lead in identifying SMEs to participate in the field test and in helping those entities do the testing and prepare their reports.
5. The deadline for submitting field test reports was initially 31 October 2007, but, in September 2007, the Board extended it and the comment deadline on the ED itself to 30 November 2007 to meet requests by field test entities.
6. Field test entities 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 ED 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 ED.
7. Field test entities were promised that their responses will be treated confidentially.

Demographics of Field Testing Sample

8. **Geographical location**. In total, 116 entities from the following 20 countries participated in the field tests:

Argentina	Italy	South Africa
Australia	Kenya	South Korea
Barbados	Malawi	Tanzania
Denmark	Malaysia	Tunisia
France	Netherlands	United Kingdom
Germany	Nigeria	United States
India	Poland	

9. **Scope.** Nearly all the field test entities do not have public accountability and hence are within the intended scope of the ED. However, one entity's shares are quoted in an unregulated market in which IFRSs are not required, and it currently uses its national GAAP, though staff believe it is likely to have public accountability as the IASB uses that term. All but a few entities stated they prepare general purpose financial statements.

10. **Form of business.** The majority of entities are limited liability corporations, or similar. Eight entities had a different form of organisation, such as partnership, cooperative, or close corporation.

11. **Annual reporting requirements**. Virtually all of the field test entities are required by law to prepare annual financial statements. Over 90% of those entities either submit financial statements to the companies registry, or similar government agency, so they are available for public inspection, or they are made available to the public in other ways.

12. **Current GAAP.** Nearly all of the field test entities currently report under their national GAAP. However 12 are full IFRS reporters (this includes country-equivalents to IFRSs) because their national law allows, or requires, unlisted entities to use IFRSs. Over half of the full IFRS reporters are in developing countries. There does not seem to be any particular correlation between being a full IFRS reporter and choosing the more complex options available by cross-reference. Overall, as might be expected, most of these 12 entities encountered very few issues in applying the IFRS for SMEs, generally raising only one or two issues each; however four of them listed a number of problems, a few of which include problems with the impairment test for goodwill (unable to find fair values for privately held subsidiaries), determining fair value for equity-settled share-based payments, applying the impairment test under Section 11 (and IAS 39), Section 11 disclosures, Section 19 disclosures, remeasurement of residual value and deferred tax requirements being too time-consuming.

13. **Size.** Approximately 70% of field test entities have 50 or fewer full time employees (including approximately 35% with 10 or fewer full time employees). The average number of full time employees across all field test entities is approximately 56. Approximately 60% of field test entities have annual turnover less than US$ 5 million (including approximately 35% with annual turnover less than US$ 1 million). The average annual turnover across all entities is approximately US$ 17million. These figures are set out to give an idea of the size

of the entities in the field testing population. However, they are not exact amounts for the following reasons:

a. A few entities only noted a range for their turnover, rather than an absolute amount. Where IASB staff has been unable to identify the exact figure, such as from the financial statements, the midpoint in the range has been used when calculating the percentages and average amounts reported earlier in this paragraph.

b. Where entities need to prepare consolidated financial statements, the total turnover and number of employees of the group has been used. However, in a few cases, group figures are unavailable (in particular when parent entities chose not to prepare consolidated financial statements for field testing purposes). In such cases, the individual entity size details have been used.

14. **Bank loans**. Approximately 60% of the field test entities had bank loans or significant overdrafts.

15. **Foreign operations**. Approximately 30% of the entities had transactions with entities in other countries or other foreign operations, for example selling goods and services to customers in other countries or having a branch or subsidiary in another country.

16. **Data availability**. As not all field test entities completed the IASB's questionnaire, the demographic data discussed in paragraphs 9 to 11 and 13 to 15 of this agenda paper above is unavailable for a few field test entities. The numbers and percentages above are based only on the entities for which necessary data is available.

Limitations Encountered during Field Testing

17. Many of the 116 field test entities provided all of the requested information, however a significant number did not provide certain documents, for example financial statements were provided without the IASB's questionnaire or the questionnaire was provided without any financial statements. A few field test entities submitted their own questionnaire or summarised their key issues in a memo, rather than completing the IASB's questionnaire.

18. Some field test entities did not prepare a full set of financial statements as they found it was too time consuming for field testing purposes. The parts commonly omitted include the cash flow statement, statement of changes in equity (or the retained earnings portion of the statement of income and retained earnings) and certain note disclosures. In a few cases, therefore, the problems noted by field test entities are perceived issues, rather than actual issues. A few field test entities noted that further problems may arise were they to need to prepare "real" financial statements under IFRS for SMEs for statutory reporting purposes, not only for voluntary field testing.

19. Since the IASB staff did not work with the individual field test entities, and in many cases financial statements were not complete, were in foreign languages, or were not submitted, it is difficult for staff to make a clear statement regarding how thoroughly the field test entities were able to apply the requirements. Where the questionnaire was submitted in a foreign language, the replies were translated for staff use. In many cases, the field test was carried out with the help of local accountants from small and medium-sized practices (SMPs) or local professional

bodies to help to ensure the ED's requirements were understood and applied correctly.

20. These limitations did not invalidate the field tests as a tool to identify implementation issues arising from use of the IFRS for SMEs. However, for some field test entities, the limitations could have resulted in the entity not identifying all of the potential implementation problems. Staff found useful information from almost every field test submission. That information is presented in the following sections of this agenda paper.

Analysis of Field Test Issues

21. The IASB staff have completed the main part of their analyses of the field tests responses. In analysing the responses, staff has carefully considered all problems identified, and additional comments made, by the field test entities. This agenda paper outlines the main issues identified and summarises the significant problems entities had in applying the principles of the ED. The following information is necessary in understanding how this agenda paper has been prepared:

    a. The focus of this agenda paper is on real problems identified in applying the principles of the ED. Hence staff have not attempted to list out all specific detailed issues identified by field test entities. Instead, a number of these are highlighted as examples if the problem with the principle is not clear on its own. Staff will review all the detailed issues again when considering what additional guidance should be incorporated into the final IFRS for SMEs.

    b. Since the sample of entities taking part in the field test is not evenly spread across different jurisdictions and continents, staff has not focussed in too much detail on the exact number of field test entities that have raised a particular issue.

    c. In some cases, the issues below do not distinguish between perceived problems and actual problems experienced by field test entities. This is because, as mentioned above, several field test entities took a few shortcuts in preparing their financial statement for field testing purposes, for example omitting certain disclosures, and several did not submit their financial statements, making it difficult for IASB staff to determine whether the issues raised by entities were actually experienced in practice or not.

    d. Although the field test was designed to solicit actual problems resulting from application of the ED in practice, several field test entities also made comments that would have been more appropriately presented in a comment letter (and which our field test questionnaire advised them to do). As these are often connected with field test problems and are similar to perceived issues, they are included in the analysis below.

    e. Certain minor issues, for instance small problems with the wording used in the ED, have not been summarised in this agenda paper. They have been included in a separate document that collates all minor issues for use by the IASB staff for reconsideration during redrafting of the ED.

General Issues in the Field Test Responses – Not Related to a Specific Section of the ED

22. **Overall impression**. Although this agenda paper sets out to summarise the problems field test entities encountered, it's worth noting from the outset that

about half of the field test entities listed no, or only one or two, issues or problems. In addition several of these field test entities said they found most of the ED to be understandable and appropriate.

23. **Scale down use of fair value**. The single most problematic area highlighted by a high proportion of field test entities is annual determination of fair value where market prices/active markets are not available. The requirement to perform annual fair value measurements for common financial instruments and residual values of non-financial assets was noted as complex, costly and often not possible due to lack of reliable values and inability to bear necessary specialists fees. Specific problems in applying fair value measurement within individual sections are set out below. In addition, many field test entities noted that the revaluation/ fair value models in different sections are not needed as they would be too difficult for SMEs to apply, for example due to lack of available indicators.

24. **Disclosures are too burdensome**. Probably the second most significant area causing problems is the nature, volume and complexity of disclosures.

    a. A significant number of the field test entities commented that the required disclosures are too onerous to prepare, in terms of time and costs. Many field test entities did not prepare some of the notes for field testing purposes for this reason.

    b. A few field test entities said that, in some cases, they were required to publicly disclose sensitive information.

    c. One field test entity, currently applying full IFRSs in their annual financial statements, said the ED does not provide much presentation and disclosure relief from full IFRSs because many areas of full IFRSs are not relevant to small firms, so migrating to IFRS for SMEs gives almost the same outcome. However, this field test entity noted that this may change once IFRS 7 *Financial Instruments: Disclosure* is effective.

25. **Further simplifications are required**. In addition to disclosure requirements being identified as too complex, many field test entities thought the ED itself could still be simplified further to eliminate some of the problems they encountered. Reasons given for problems include information not being available or not available without undue effort, staff do not have expertise and costly outside experts would be necessary. Many field test entities did not highlight specific problem areas, but, where they did, these are listed by section below. Several field test entities commented that overall the language in the ED could be simplified. Some field test entities said they would prefer to use full IFRSs if international accounting standards were deemed necessary since the ED provides little relief from full IFRSs and could be perceived by users as “second best”.

26. **The ED would increase costs**. Our questionnaire asked whether the field tester would expect the requirements in the ED to increase auditing costs. While most respondents do not anticipate a significant increase, are not subject to audit or simply did not respond, several field test entities said the requirements would increase costs. Some entities also noted that other costs would increase due to more work for management and accounting staff to collect information and prepare financial statements, and also the need for more advisors and specialists.

27. **Make IFRS for SMEs standalone and improve its structure**. Some field test entities said all relevant requirements should be within IFRS for SMEs and all

cross-references should be removed. Approximately 20% of entities either noted they referred back to full IFRSs in order to apply an option available by cross-reference to full IFRSs or said they would have liked to use an option only available by cross- reference. The most commonly used options from full IFRSs were the revaluation model under IAS 16 *Property, Plant and Equipment*; the capitalisation methods under IAS 23 *Borrowing costs* and IAS 38 *Intangible Assets*; and also the option to apply full IAS 39 *Financial Instruments: Recognition and Measurement*. A few field test entities said that needing to refer back to full IFRSs to apply certain options was problematic. Some field test entities, generally those already applying requirements similar to full IFRSs, noted that they would prefer all options in full IFRSs to be included. Some of the smaller field test entities suggested deletion of options to decrease costs and increase comparability. In addition, some entities feel that, although requirements in the ED are relatively easy to find, the structure of the ED could be more orientated to the balance sheet to ease use**.**

28. **Guidance from full IFRSs**. Other than to use options available by cross-reference, only about 7% of entities specifically noted that they needed to refer back to full IFRSs in order to understand or clarify requirements in the ED. Many entities did not list specific areas, but some of those that were specified are related party transactions, contract revenue, deferred taxation, and contingent consideration in a business combination.

29. **Add more guidance and examples.** Many field test entities said they found the Implementation Guidance, and also the examples in Section 20 (Provisions) and 22 (Revenue), very useful. Several field test entities suggested examples should be provided for other sections, in particular in complex areas, such as pensions and leases, and also in areas that all SMEs commonly encounter. Several field test entities suggested specific examples, particularly for revenue recognition, and some of these are set out under the relevant sections below. In addition, a few field test entities requested illustrative guidance on the format of financial statements for other industry sectors, in particular the financial service sector.

30. **Use of software.** A few field test entities said they had avoided application problems by using certain types of software, for example AS Reflex and PROTEFI/OPEN LEASE software.

Field Test Issues Related to a Specific Section in the ED

Section 1 – Scope

31. **Problems applying the definition of an SME.** Some examples of problems in applying the definition include:

    a. Interpreting “in the process of filing” as used in paragraph 1.2(a) of the ED.

    b. Confusion since the definition of SME is inconsistent with the definition of SME in a particular jurisdiction.

    c. Confusion since the definition only refers to publishing general purpose financial statements for external users, but the SME owner manager is the main user of the financial statements.

32. **Additional comments**. As well as having problems with applying the definition, some field test entities made comments on the scope of the ED. Some of the more significant comments include:

   a. It's better to use a different term than SME, for example "Private Entities". The word SME causes confusion as it excludes larger entities.

   b. The definition of public accountability is too wide. The condition "holding assets in a fiduciary capacity" could effectively exclude many SMEs from the scope of the ED.

   c. Give quantitative requirements for SMEs.

   d. Remove reference to 50 employees (BC45).

   e. The ED in its present form is designed for medium-sized rather than small entities. A separate standard for small entities could be developed which excludes some of the ED's requirements, for example the requirement to prepare a cash flow statement or consolidated financial statements.

   f. All entities should have the option to use either full IFRSs or IFRS for SMEs (regardless of public accountability). Delete 1.3.

   g. IFRS for SMEs is not relevant to owner-managed entities since they do not need to produce financial statements for a wide range of users.

Section 2 – Concepts and Pervasive Principles

33. **Fair value measurement is troublesome and not cost effective**. A few field test entities noted that fair value measurement requirements in 2.41 - 2.43 are burdensome, in particular the subsequent measurement requirements for non-financial assets in 2.42 (i.e. the lower of cost and fair value less costs to sell). Some field test entities commenting on 2.42 noted fair value is not determinable as there is no relevant industrial index or market data in their jurisdiction, as is often available in more advanced / developed countries.

34. **Other issues.** Some of the other more significant issues raised in Section 2 include:

   a. Substance over form is a new concept that is difficult to understand.

   b. For certain requirements in IFRS for SMEs, the benefits derived from the information are not justified by the costs of providing it. It was suggested that a definition of benefits, used in 2.11 to discuss the balance between costs and benefits, would be useful.

   c. A few field test entities used the qualitative characteristic "balance between costs and benefits" in 2.11 in order to justify non-compliance with certain requirements of the ED, for example not preparing consolidated financial statements. This may suggest a need to elaborate on the role of the characteristics in the IFRS for SMEs.

Section 3 – Financial Statement Presentation

35. Only a few field test entities highlighted issues in this section. Three such issues are:

a. Unsure what disclosures to provide as company ceased trading in the year.

b. Applying the new format and order for the financial statements was time consuming.

c. Applying the term materiality led to problems, for example relating to dormant subsidiaries.

Section 4 – Balance Sheet

36. **Current versus non-current**. A few field test entities had difficulties in classifying items between current and non-current. Some field test entities said this was because their current information system is not adapted to produce certain information. It was noted that the illustrative financial statements could be edited to helpfully provide descriptions of the financial assets and liabilities in the balance sheet to assist classification of financial instruments.

37. **Designation of line items.** Several field test entities are unsure of which line items to show on their balance sheet, for example, whether a subtotal for financial liabilities is needed or whether separate line items are needed for tax liabilities other than income taxes or for amounts due to related parties.

Section 5 – Income Statement

38. **"By function" versus "by nature".** There was a slight preference for the "by function" presentation for the income statement in the sample of field test entities. However, both methods were widespread in our sample.

39. **Other issues.** Very few field test entities had any major issues with this section. Some of the more significant issues identified include:

    a. Current information systems cannot produce certain information and so time consuming manual calculations were required.

    b. The "by function" presentation of the income statement is impracticable due to the need to segregate distribution and administration expenses.

40. **Additional comments.** Some field test entities made specific comments in Section 5, for example disclosure of depreciation/ amortisation and the employee benefits expense should always be required. The ED requires disclosure for the "by nature" presentation only if deemed necessary to an understanding of the entity's financial performance (5.5).

Section 6 – Statement of Changes in Equity and Statement of Income and Retained Earnings

41. **Choice of presentation**. Of the field test entities complying with this section, about half preferred to present a statement of income and retained earnings instead of a statement of changes in equity.

42. **Reasons for non-preparation of statement.** A few field test entities did not present a statement of changes in equity (or a statement of income and retained earnings) as many of them do not need to prepare such a statement under national requirements. Field test entities either did not provide reasons for this, said they

did not see the need for such a requirement (so presented the movements in equity in the notes) or noted that it would have been time consuming and burdensome to produce either statement (rather than too complex) especially since such preparation was only for voluntary field testing purposes, rather than for statutory reporting. IASB staff feel that a few entities seemed to have simply been put off looking at Section 6, as they saw it as requiring a new primary statement, since most of these entities would qualify to prepare a statement of income and retained earnings, which would be relatively quick and easy. A few field test entities said their current information system is not adapted to produce a statement of changes in equity. One field test entity does not see the relevance of such a statement for their organisation. Several field test entities suggested it would be very useful to have an example of a statement of changes in equity within the Implementation Guidance. (Currently the Guidance only has an example of a combined statement of income and retained earnings.)

43. **Other issues.** Only a few field test entities identified specific problems when preparing either statement. One problem noted is it is difficult to measure the amount in 6.2 (b), i.e. each item of income and expense that is recognised directly in equity

Section 7 – Cash Flow Statement

44. **Choice of presentation**. Only a small number of field test entities that produced a cash flow statement chose the direct method of reporting operating cash flows. Supporting reasons for choosing the direct method include it being easier based on available information, it being considered to give more relevant information (i.e., clearer where cash is coming from and going to) and the supervisory board requiring the direct method to be used. In addition, a few field test entities applying the indirect method specifically stated requirements for the direct method should be fully included in the IFRS for SMEs (not by cross-reference). A few field test entities said they had no choice but to use the indirect method as their current information systems would not be able to cope with the direct method.

45. **Reasons for non-preparation of statement.** A few field test entities did not present a cash flow statement. Most of those noted that currently they do not need to prepare such a statement under national requirements. The main reasons given for not presenting a cash flow statement are centred on the fact it is time consuming and burdensome to produce, rather than complex. Some field test entities decided it was not worth producing the cash flow statement for voluntary field testing purposes. A few field test entities said their current information system is not adapted to produce such information. A few field test entities did not prepare the operating cash flows section because they were not asked to produce comparative prior year information for field test purposes. Several field test entities acknowledged that the cash flow statement is important information for banks and other users. Very few field test entities specifically stated they cannot see the benefit of a cash flow statement.

46. **Other issues.** Some of the more significant issues identified by the field test entities include:

a. Problems classifying cash flows, for instance, whether certain bank deposits are investing or financing and whether repayments of advances are operating or financing.

b. 7.18, concerning disclosure of non-cash transactions, is hard to understand and an illustration would be helpful.

c. 7.13, concerning unrealised gains and losses from changes in foreign currency exchange rates, is too burdensome.

Section 8 – Notes to the Financial Statements

47. **Disclosure of judgements and estimation uncertainties**. The main issues identified in Section 8 relate to disclosure of judgements and key sources of estimation uncertainty. Some field test entities do not think these disclosures should be required for small entities. A couple of field test entities are uncertain as to when they need to make such disclosures.

48. There were a number of comments on note disclosures in general and these are discussed in paragraph 24 of this agenda paper above.

Section 9 – Consolidated and Separate Financial Statements

49. **Assistance and guidance**. Some field test entities are required to prepare consolidated financial statements under the ED; however quite a few of them chose not to do so (see comments below). Many of these field test entities said they do not need to prepare consolidated financial statements under their local GAAP. Hence, they would require assistance, for instance from their auditors, and several suggested more guidance and examples are required. Some of the areas where field test entities think guidance and examples would be useful are:
    a. Illustrating minority interests in the illustrative financial statements.
    b. How to determine which of their affiliates are subsidiaries and, therefore, need to be consolidated.
    c. Consolidation methods and acquisition and disposal dates.
50. **Reasons for non-preparation of consolidated financial statements.** A few field test entities said they did not prepare consolidated financial statements as it would have been too burdensome, but not many field test entities explained specifically what made them burdensome. Some field test entities envisaged problems due to different reporting dates and the need to apply uniform policies. Some specific reasons given for non-preparation include:
    a. Absence of reliable information, for example for a subsidiary in liquidation.
    b. Subsidiary has not had significant transactions since incorporation so consolidated financial statements were not presented under local GAAP (full IFRSs) as it was considered it would cause undue delay.

Section 10 – Accounting Policies, Estimates and Errors

51. **Ambiguity regarding changes in accounting policies on adoption.** A few field test entities feel there is ambiguity as to whether a change in accounting policy on transition from local GAAP, in particular where this is full IFRSs, to IFRS for SMEs is subject to the provisions of IFRS for SMEs regarding changes in accounting policies. (Staff note that Section 38 provides guidance for first-time adoption and Section 10 does not apply.) If a change on transition is considered to be a change in accounting policy, then the entity may not be able to justify changing to a simpler accounting policy on the grounds that the current policy provides reliable and more relevant information. This may hinder the use of simpler options, for example measuring associates at cost, if an entity previously applied equity accounting. This is an area where clarification in the final IFRS for SMEs will be helpful.
52. **Other comments.** As field test entities were applying the ED for the first time, parts of Section 10 were not relevant and hence not many issues arose. However, a few field test entities made comments on the section. Two significant comments made by field test entities are:
    a. The hierarchy in 10.2 – 10.4 should clarify that accounting outcomes differing from full IFRSs are acceptable. Currently, some found it unclear whether SME specific solutions can be derived at all.
    b. Adjustments to the financial statements due to errors relating to prior periods would be difficult to calculate due to the nature of our business and so disclosure would be the only solution, an example provided was that it'd be

difficult to determine in which period the cause of a loss to agricultural produce arose.

Section 11 – Financial Assets and Financial Liabilities

53. **Overall.** Section 11 was the section that seemed to cause the most problems and received the most comments from field test entities. Most issues noted were very general, for instance comments like costs outweigh benefits, but several field test entities also identified specific issues relating to Section 11.

54. **Scope.** Some of the more significant problems relating to the scope of this section include:

    a. Many field test entities did not apply Section 11 as they have a misconception that Section 11 is only relevant for entities with complex financial instrument activities, such as hedging. Some field test entities feel it is not apparent, for instance, that plain receivables and payables are also addressed in Section 11 (the list in paragraph 11.2 notwithstanding). Some field test entities noted clarification of the transactions addressed in this section is necessary to overcome this problem, for instance by using simpler language and less abstract wording.

    b. Lack of clarity on whether Section 11 includes statutory obligations. It would be beneficial to explain that certain liabilities, such as tax obligations and government-mandated employee benefits are not financial instruments under Section 11 because they are statutory obligations covered in other sections of the ED in order to avoid incorrect classification.

    c. Problems deciding whether certain other instruments are within the scope of Section 11, for example provisions for contingent consideration and government grants in the form of repayable advances.

55. **Classification.** Many field test entities found it difficult to determine which financial instruments can be measured at amortised cost as they find 11.9 difficult to understand. Some field test entities recommended that 11.9 should be set out more simply and clearly to help understanding. Only a few field test entities actually stated which instruments they had particular problems classifying and these were interest-free trade receivables / payables and interest-free intercompany loans, as entities are unsure if they meet the requirement to have a fixed rate of return under 11.9(b).

56. **Fair value.** Many field test entities feel the fair value requirements in the ED require undue cost or effort. Some field test entities measured all financial instruments at cost due to difficulties applying fair value. Some of the more significant issues noted by field test entities as to why they were unable to, or did not want to, fair value or encountered difficulties applying fair value measurement requirements include:

    a. Use of external experts is not financially possible for SMEs.

    b. Asset base is too small to justify cost of calculating fair value annually.

    c. Fair value measurements of non-quoted instruments result in undue cost and effort, in excess of benefits.

d. No reliable measure of fair value for certain instruments.

e. Appendix B, covering fair value measurement, is difficult to understand and often not relevant. Practical examples are necessary.

f. It's unclear how to determine whether a market is active or inactive. Further guidance is needed. For example, the stock market in certain countries is generally inactive, so fair value measurements may not be reliable even for 'quoted' instruments.

g. Fair value measurement of derivatives is difficult and so was not performed. A valuation should have been performed by an expert, but this was not done due to cost. However, a few field test entities that highlighted this point said it should not be an issue going forward, if applied on a regular basis, as the bank which provided the derivative should be able to provide a valuation.

57. **Cost as default**. Some field test entities said cost should be the default category, with fair value only rarely applied. Some field test entities also suggested the option to take fair value gains and losses to equity should be available in Section 11, particularly where fair value has been determined based on quoted prices from relatively inactive markets or imprecise valuation techniques.

58. **Effective interest method.** Several field test entities said that they had problems applying the effective interest method, for instance when measuring trade and other receivables. Many of these field test entities said that Appendix A is too complex. A few field test entities suggested practical examples are necessary.

59. **Hedging.** Very few field test entities performed hedge accounting, which is optional under 11.29. Some field test entities said the requirements are too complex for them and other field test entities suggested requirements for hedge accounting should be removed altogether. Of those field test entities applying hedge accounting, where details were given, hedging was predominately confined to interest rate or cross currency swaps. Some of the problems that arose include:

    a. Problems understanding and applying the requirements for testing hedge effectiveness. Some field test entities suggested additional guidance is desirable. Some noted that use of external experts is not financially possible.

    b. For a perfect hedge (interest rate swap), reporting the gain in equity does not gives a true and fair view. It'd be better to require disclosure only.

60. Some field test entities said hedging should be allowed for types of risks in addition to those in 11.31. A few field test entities said they would be prevented from doing hedge accounting under the ED in circumstances where hedging was appropriate.

61. **Impairment.** A small number of field test entities had difficulties with the impairment requirements in Section 11. Some of the more significant problems relating to the scope of this section include:

    a. 11.22(a) requires an impairment measurement which causes undue cost or effort and is based on an effective interest rate calculation which is not a precise determination of impairment anyway.

    b. Unsure how to apply the method of determining the present value of estimated cash flows discounted at the financial asset's original effective interest rate under 11.22(a).

c. The impairment test in 11.22(b) for equity instruments carried at cost contradicts their classification under 11.7(c) (“fair value cannot otherwise be measured reliably”).

62. **Disclosures.** Many field test entities feel the disclosure requirements in Section 11 are too onerous. Most comments by entities were general, for example disclosures are too onerous, rather than highlighting specific problems. Some of the more significant specific comments include:

a. A more principle-based approach for disclosing financial instruments would be better than a checklist approach. More discretion should be given to SMEs to determine the appropriate level of disclosures.

b. Avoid disclosure of “regular risks” unless important to users of financial statements.

c. Disclosures in 11.41 (balance sheet categories of financial assets and financial liabilities) are cumbersome and there is no related guidance in the illustrative financial statements.

63. **Additional guidance.** Many field test entities feel more guidance, with examples, should be provided for certain transactions. Examples given were hedge accounting, applying the effective rate interest method and debt factoring.

Section 12 – Inventories

64. **Allocation of costs.** Several field test entities had problems applying the full cost approach. Some field test entities feel it is administratively onerous to measure indirect production costs and they noted that their reporting systems cannot handle such costs. Other field test entities said it was difficult to determine how to allocate costs, for example allocation of transportation costs and costs not directly attributable to one product. Some field test entities said they agree with the concept in general, but, since application is difficult, more guidance is needed on how to determine which costs to include in inventories.

65. **Deferred payment.** A few field test entities noted they are unsure how to treat deferred payments to suppliers that have no additional amount for financing as they feel Section 11 and 12 conflict. They noted Section 11 requires the financial liability to be measured at the present value of the future disbursement, but 12.6 appears not to recognise the financing element. (Staff believe that 12.6 is specifically intended to recognise the financing element, so redrafting rather than a change of principle seems warranted.)

Section 13 – Investments in Associates

66. **Choice of methods.** Several field test entities have associates. The most popular method chosen by the field test entities was the cost method, with a few field test entities applying the equity method. Some field test entities acknowledge that the cost method was simpler, but the equity method often provides better information. A few field test entities see the relevance of the fair value method, but several others do not find it relevant for SMEs. A few entities agree with allowing different options for associates, but feel all options should be fully explained in the ED.

Section 14 – Investments in Joint Ventures

67. **Choice of methods.** Very few field test entities have jointly controlled entities, and those that do are generally part of large groups. Also, the few field test entities with jointly controlled entities did not provide full financial statements for field test purposes, however they noted that the cost method is simpler, but the equity method may provide better information. A few field test entities see the relevance of the fair value option, but several others do not find it relevant for SMEs. A few entities agree with allowing different options for jointly controlled entities but feel all options should be fully explained in the ED.

Section 15 – Investment Property

68. **Use of fair value.** Of those field test entities with investment properties, nearly all used the cost method. Some field test entities commented that they did not use fair value for cost-benefit reasons, and some noted that the fair value model is only useful if observable market prices exist.

69. **Other issues.** Some of the more significant issues identified by field test entities include:

    a. Classifying leasehold property as investment property causes problems.

    b. Separating mixed use property between investment property and property plant and equipment is not justified based on cost benefits in certain cases.

Section 16 – Property, Plant and Equipment

70. **Residual value**. A high proportion of the field test entities encountered problems with the requirement to perform an annual review of residual values of assets. In addition, several field test entities stated they had deemed all assets to have no residual value, but did not give their reasoning. Several field test entities noted that the annual review of useful lives and depreciation methods causes undue cost compared to benefits. Some field test entities suggested reviews of residual values/ useful lives should take place at longer periods of time or only if conditions arise that would require such reviews to be performed. Some of the more significant issues noted by field test entities relating to why they were unable to determine residual values, or why they believe annual remeasurement causes undue costs compared to benefits, include:

    a. Residual value can be hard to estimate and it's questionable whether this has benefits in the financial statements of small entities.

    b. Active markets do not exist for certain assets / in certain jurisdictions

    c. Residual value is not relevant to a long term point of view.

    d. Local tax law presumes zero residual value for tax depreciation purposes.

71. **Revaluation model.** Very few field test entities used the revaluation model for property, plant and equipment. Of those that did, most used it for property and did not give specific reasons for their choice. They noted that it was problematic to need to refer to IAS 16 *Property, Plant and Equipment* in order to use this method.

Several field test entities feel the revaluation option should be removed. One entity noted that its land value was much higher than its reported carrying amount and that this may be important information in order to show a true and fair view. This entity suggested that if disclosure of the amount of square metres of land owned was required, then users could determine fair value themselves, without burdening SMEs.

72. **Other issues.** Many field test entities feel that certain parts of this section, for example application of component depreciation and determination of useful lives, could benefit from additional guidance. Some of the more significant issues identified by field test entities include:

    a. A few paragraphs are troublesome, for example 16.7(c) regarding estimating dismantling costs and 16.10 regarding deferred payment and exchanges of assets.

    b. There is room for interpretation as to what the term "incremental future benefits" actually means and further guidance is needed. A few field test entities disagreed that costs associated with a maintenance visit should be capitalised as they do not think incremental benefits are generated.

    c. Component depreciation is not relevant and would cause problems if applied strictly.

Section 17 – Intangible Assets other than Goodwill

73. **Revaluation model.** None of the field test entities appeared to use the revaluation model, although a few of them said they would consider using it but that it would be problematic to need to refer to IAS 38 *Intangible Assets* in order to do so. Several field test entities stated that a revaluation option for intangibles is unnecessary.

74. **Capitalisation model.** A few field test entities chose the capitalisation model for development costs. One of the main reasons for doing so was that it is considered to give a fairer presentation of the success of their investment in product development. Several field test entities noted that currently their systems do not allow them to determine the cost of internally generated intangible assets. Some of the entities applying or considering applying the capitalisation model stated that clearer guidance is necessary to help distinguish between research and developments costs. They also said the reference to IAS 38 in order to use the capitalisation model is problematic.

75. **Other issues.** Most field test entities did not have intangible assets. Of those that did, some of the more significant issues identified include:

    a. Determining whether certain assets are intangible assets, for example upfront payments made to third parties to conduct research.

    b. Determining whether intangible assets have a finite or an indefinite life.

    c. Annual review of useful lives and depreciation methods causes undue cost compared to benefits. It was suggested that such a review should be required at longer periods of time or when conditions arise that would require it to be performed.

d. The removal of amortisation for indefinite life intangibles causes problems as it would generally be very subjective or even impossible to carry out an impairment review.

Section 18 – Business Combinations and Goodwill

76. **Issues.** Very few field test entities needed to apply Section 18. Some of the more significant issues identified by those who did include:

    a. Difficulties determining how to account for contingent consideration.

    b. Difficulties identifying intangible assets in a business combination. It was noted that unless specific intangibles are given as examples within IFRS for SMEs, entities are unlikely to look for such assets.

    c. Unclear how to account for adjustments to the fair values of identifiable assets and liabilities after acquisition, for instance it appears possible to make adjustments without any limitation.

77. **Additional comments.** Some entities made additional comments on areas they did not need to apply during preparation of their financial statements. Some of the more significant comments made include:

    a. The removal of amortisation for goodwill would cause problems as it would generally be very subjective or even impossible to carry out an impairment review. It is also difficult to identify impairment indicators.

    b. Section 18 appears very complex and hence it would be very costly to apply, yet the resulting benefits seem rather limited. It was suggested that this is one area where the IASB should try to give SMEs material relief, particularly regarding the disclosure requirements.

    c. Disclosures required by 18.23(h), regarding why the fair value of some intangible assets may not be reliably measurable, would seem to be impracticable.

    d. Disclosure of the cost of business combinations (18.23(d)) is very sensitive for SMEs.

Section 19 – Leases

78. **Measurement issues on reclassification as finance leases.** Some field test entities needed to recognise finance leases on their balance sheet for the first time, since under their local GAAP only note disclosure is required. A few entities feel this causes ‘undesirable’ effects as it impacts their capital. Some entities said information about the fair value of the leased asset was unavailable to measure finance leases or was burdensome to identify. Some entities feel that measuring the fair value of the leased asset is less practicable than if entities were able to use the present value of minimum lease payments.

79. **Classification.** A few field test entities encountered problems applying the classification criteria in Section 19, for example (a) applying the factors in 19.4 (determinative factors) and 19.5 (additional indicative factors) or (b) determining when factors in 19.5 (additional indicative factors) would lead to finance lease

classification, in the absence of factors in 19.4 (determinative factors). Several entities suggested examples and quantitative thresholds would be very beneficial.

80. **Finance lease (lessors).** A few entities were lessors under finance leases, and they found it problematic to need to look back to IAS 17 *Leases* for the relevant requirements.

81. **Disclosure.** Several field test entities found disclosure of minimum lease payments for each future year onerous, especially where they have a number of assets held under leases. A few field test entities feel that some of the disclosures in Section 19 are of little benefit to users, for instance regarding contingent rentals and leasing arrangements. One entity was unsure what to disclose in relation to the sublet of its premises.

82. **Other issues.** Some entities noted that the requirements in Section 19 would lead to medium to high benefits for users, but some areas were costly to apply. Some of the more significant additional issues identified include:

    a. Lack of guidance for lease incentives, a common feature of lease arrangements.

    b. Unsure how to account for hire purchase payables (liability recognised under finance lease).

    c. Some entities feel it is important in their particular jurisdiction to have a specific exclusion for leasehold land from 19.4(c) – "the lease term is for the major part of the economic life of the asset even if title is not transferred."

Section 20 – Provisions and Contingencies

83. Only a small number of entities noted difficulties with applying Section 20. Several entities said the requirements for provisions and contingencies in the ED are very similar to their national GAAP and several others said they do not have provisions (other than those specifically covered by other sections of the ED) or contingencies. A few entities consider present value calculations cause undue cost or effort. A few entities noted that additional guidance or examples would be useful, for example illustrating the accounting for insurance receivable and the theory of using weighted average expected amounts (20.8(a)). Examples of provisions recognised by the field test entities include provisions for warranty costs, risk in delivering live agricultural products and for future committed development of land.

Section 21 – Equity

84. **Classification between debt and equity.** Several field test entities are partnerships or cooperatives and most of them noted that, under the ED, they have no equity, which does not appropriately reflect their view of reality. Several entities said clear guidance on the differentiation between equity and liability is necessary and some suggested the recent changes to IAS 32 *Financial Instruments: Presentation* for puttables and obligations arising only on liquidation should be integrated into the IFRS for SMEs. Only one field test entity appears to have convertible debt and this entity encountered problems classifying and measuring the instrument into its debt and equity parts.

Section 22 – Revenue

85. Several field test entities highlighted measurement issues relating to revenue, especially concerning the use of the percentage of completion method. Some entities noted that while the benefits to users of the percentage of completion method are high, so are the costs to preparers. Some entities encountered measurement issues in other areas, for example it took time to identify how to apply the concept substance over form for the first time and time to understand how to account for sales tax. Several field test entities requested additional examples. Some of the specific requests include:

   a. Contracts for services. A few entities said this should cover issues in UITF 40 *Revenue recognition and service contracts*.

   b. Applying the percentage of completion method, for example when recognising fees for professional services.

   c. Real estate sales, to avoid the inconsistencies in reporting such sales as addressed by IFRIC D21 *Real Estate Sales*.

   d. Property development activities.

   e. Biological and agricultural (plantation) activities.

   f. Recognition of interest income using the effective interest method.

   g. Rental income received.

   h. Complex arrangements such as sales with multiple deliverables.

Section 23 – Government Grants

86. Only a small number of field test entities have government grants. Some applied the IFRS for SMEs model and others chose an option from IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. A few entities noted the description of the options is unclear, in particular for the IFRS for SMEs model. A few entities encountered problems restating existing grants to comply with IFRS for SME. Some of the specific issues identified include:

   a. Measuring grants at fair value causes problems due to lack of easily available indicators of the value of the asset or other benefit received.

   b. Unsure how to measure the liability for grants in the form of repayable advances.

   c. Difficult to allocate a government grant to the components of an asset.

   d. Unsure how to classify certain grants in the income statement, for example grants received by way of a reduction in social charges and grants related to research and development expenses on internal projects.

Section 24 – Borrowing Costs

87. Most field test entities did not have borrowing costs eligible for capitalisation. Of those that did, about half of them chose capitalisation. No significant issues were identified.

Section 25 – Share-based Payment

88. Only a very few of the field test entities had share-based payment transactions. Two had equity-settled share-based payment transactions, and they commented that they were unable to measure fair values of either the shares or the share options. In addition, a few entities that did not have any share-based payment transactions commented that they would have found Section 25 difficult had they needed to apply it.

Section 26 – Impairment of Non-financial Assets

89. **Impairment of goodwill.** Several entities have goodwill in their balance sheet, and, out of these, several entities said they needed to consider the impairment requirements for goodwill. Of those that did, most experienced problems either applying the impairment test or applying the impairment indicators. The most significant problem experienced by the entities was determining the fair value less costs to sell for the group of assets to which goodwill is allocated, for example it was difficult to determine the fair value of a privately held subsidiary due to a lack of market transactions / lack of comparable companies with market transactions. Several entities feel that SMEs should have the option to amortise goodwill.
90. **Value in use versus fair value.** Several field test entities noted that value in use should be reintroduced; otherwise more frequent impairment losses will be recognised, which are not justified, for example for computers which are being used in the business. Some entities noted that the requirement to use fair value to determine impairment causes problems due to the lack of available indicators.
91. **Other issues**. Only a few field test entities identified further areas of difficulty. One specific issue relates to problems determining the impairment of inventory in the agricultural business.

Section 27 – Employee Benefits

92. **Use of defined benefit plans**. Several field test entities have defined benefit plans. Some of these entities use outside specialists to value the plans so they did not encounter any problems. A few entities noted that use of outside specialists would be needed, but would be too costly.
93. **Other issues**. A few field test entities found Section 27 challenging and noted that costs exceed benefits in areas. Some of the more significant issues identified include:
    a. Unable to gather enough data to make estimates about demographic and financial variables as required by 27.16 for defined benefit plans.
    b. Difficulties recognising and measuring certain employee benefits, for example where entities have a choice of benefits and for indemnities relating to the end of an employee’s employment.

c. Information to determine the holiday pay accrual was not available.

d. Unclear whether employee benefits should be a provision or an accrued expense.

e. Disclosure requirements in 27.36 -27.41 have no practical use for users. [This is essentially all disclosures about employee benefits required by the ED.]

Section 28 – Income Taxes

94. **Issues.** Several field test entities feel that deferred tax is too complex for SMEs. However, a few other field test entities support deferred tax requirements as deferred tax is useful information for assessing cash flows. Several entities had problems with areas of Section 28. Some of the more significant issues identified include:

a. Problems measuring temporary differences. Measurements in the field entity's restated financial statements are 'rough' or are not finalised.

b. The concept of recognising a deferred tax asset is not practical for SMEs since SMEs do not prepare the necessary budgets/forecasts. A few field test entities noted particular problems with tax loss carry forwards as the entities only prepared limited forecasts.

c. Unsure whether deferred tax assets and liabilities can be offset as there is no guidance. Offset is a common issue.

d. Problems determining tax rates where, depending on the level of profits of the year, the entity may use a "reduced rate" on part of or all its profits.

e. Difficulties understanding certain paragraphs, for example 28.17 on initial recognition and 28.25 on measuring deferred tax at the rates applicable to undistributed profits.

f. Disclosure issues, for example certain information is difficult to provide and the tax reconciliation (28.29(b)) is difficult to prepare

95. **Additional comments.** Some of the more significant comments made by field test entities include:

a. Explanation of the underlying concept should be improved. It would be easier if the IASB used only one concept, either the timing or the temporary difference concept.

b. 28.18 should note that if an entity considers the timing differences to be insignificant then there is no need to recognise deferred tax.

c. 28.18(b) should provide the same exemption for unremitted earnings of local subsidiaries as it does for foreign subsidiaries.

Section 29 – Financial Reporting in Hyperinflationary Economies

96. No entities needed to apply this section.

Section 30 – Foreign Currency Translation

97. Only a few field test entities highlighted issues in this section. Two such issues are:

    a. More guidance on application of the requirements relating to net investment in a foreign operation would be helpful.

    b. SMEs should not need to apply functional currency requirements since the presentation currency required by law is the local currency and it would be costly and unnecessary to keep financial statements in both the functional and presentation currencies.

Section 31 – Segment Reporting

98. None of the field test entities appeared to have prepared segment information based on IFRS 8 *Operating Segments*, however several entities said they would consider preparing segment information if they didn't need to comply in full with IFRS 8.

Section 32 – Events after the End of the Reporting Period

99. Of those entities considering this section, only one significant issue was identified which was specific to their business**.**

Section 33 – Related Party Disclosures

100. **Disclosure of KMP compensation.** Several entities feel such disclosures reveal sensitive information and are not appropriate. Some entities do not think it is relevant to require disclosure of management personnel compensation when the shareholders of the entity are usually the directors. For a few entities the information would only comprise the owner of the entity and hence owner-managers are very concerned by this requirement.

101. **Other issues**. Several field test entities found the related party requirements onerous. Some entities do not see the relevance of related party disclosures in a non-listed environment. Some noted the definition of a related party is too wide, for example it was suggested it could be reduced to a holding company and subsidiary relationship. Some field test entities noted they can see the benefits of providing related party disclosures to users. Some of the more significant issues identified include:

    a. Problems applying the definition of a related party, for example determining who is related.

    b. Sourcing of related party information takes a lot of time

    c. Requirements may cause competitive harm. Related party disclosures might reveal sensitive information which can cause indirect or opportunity costs.

    d. Disclosure requirements are difficult to understand and still too complex, particularly 33.7 to 33.10 [disclosures about related party transactions].

Section 34 – Earnings per Share

102. Very few of the field test entities presented earnings per share figures. However, several more entities said they would consider providing such information if they did not have to comply in full with IAS 33 *Earnings per Share*.

Section 35 – Specialised Industries

103. **Agriculture.** In this section, all significant issues identified by field test entities relate to agriculture and mainly focus on use of fair values. Of the few entities needing to apply this section, most had problems with the requirement to use fair values for biological assets and agricultural produce and feel the cost model should be allowed because fair values are either not available, or because undue cost and effort is required to determine such values. Some other significant issues identified include:

a. Difficult to determine the movements in biological assets needed for the fixed asset reconciliation. It was suggested that biological assets should only be classified as non-current after a number of years of production and before that they should be classified as inventory. For inventory, reconciliation of movements is not required and the entity considers this provides sufficient Information.

b. The costs involved in complying with the disclosures in Section 35 exceed the benefits for users.

Section 36 – Discontinued Operations and Assets Held for Sale

104. Several field test entities do not think that separate measurement requirements for discontinued operations and assets held for sale are necessary for SMEs as they are too burdensome and costly, with limited benefits. Some additional significant issues identified include:

a. Difficult to identify cash flows connected with discontinued operations and assets held for sale.

b. Difficult to determine fair value less costs to sell for held for sale items, for example for certain buildings.

c. Difficult to determine when an asset should be classified as held for sale. More guidance is necessary.

Section 37 – Interim Financial Reporting

105. Very few of the entities produce interim financial statements. No issues were identified.

Section 38 – Transition to the IFRS for SME

106. **Impracticability exemption.** A few entities said they used the impracticability exemption for certain issues, for example where information was not available, such as fair values for assets, or where adjustments were considered burdensome,

for example restating the impact of government grants in the income statement. One entity suggested the impracticability exemption is likely to be needed by many small entities in its jurisdiction. A few entities are unclear how the impracticability exemption should be interpreted, for example whether several items could remain at previous GAAP measurements and / or whether they could use a previous GAAP balance sheet as the opening balance sheet if restatement was considered impracticable.

107. **Other issues.** Some of the more significant other issues identified by field test entities include:

a. Unclear under which line item to disclose the differences resulting from applying different measurement methods.

b. Problems preparing the reconciliations required by 38.11-38.13.