30 Cannon Street, London EC4M 6XH, United Kingdom
Phone: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

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:	**Checklist of Issues for Working Group Discussion Other than Disclosure Issues (Combines the Issues in Agenda Papers 1 and 2) (Agenda Paper 3)**

Objective of Discussion at this Working Group Meeting

1. This agenda paper (Agenda Paper 3) combines the issues identified in Agenda Papers 1 and 2 for the 10-11 April 2008 SME Working Group (WG) meeting:
    a. Agenda Paper 1 (AP1) highlights the main issues (other than disclosure issues) in the comment letters on the Exposure Draft (ED) of a Proposed IFRS for SMEs.
    b. Agenda Paper 2 (AP2) highlights the main issues that were identified as a result of the programme for field testing the ED.
2. The purpose of Agenda Paper 3 is to make the Working Group discussion easier by creating a checklist that integrates the two sets of issues and adding questions to focus the discussion. <u>Agenda Paper 3 does not introduce any new issues.</u>
3. Those paragraphs of this paper that come from AP1 are shown with the source paragraph indicated in square brackets. For example, the reference to **[AP1.21]** inserted at the start of paragraph 9 indicates the source is paragraph 21 of Agenda Paper 1.
4. Supplementing the paragraphs from AP1, this agenda paper adds 'boxes' as follows:
    a. Issues that were raised in the field tests (from AP2) are shown in a shaded box immediately following the related issue(s) from AP1. These are marked **FT**

for field test and the related paragraph in which the issue appears in Agenda Paper 2 is given. For example, in the shaded field test box following paragraph 9(b) below, **FT [AP2.27&80]** means this issue arose as a result of the field tests and was reported in paragraphs 27 and 80 of Agenda Paper 2.

b. **Staff comments** have been inserted in white boxes where staff felt some additional information might be useful for the WG discussions.

c. Questions that staff asks the WG members to consider are in a white box and presented in ***bold italic type***. A substantial portion of the two day meeting of the WG will be devoted to these questions. There is space in the question boxes for WG members to make notes while reading through this agenda paper.

5. Therefore, assuming that WG members have already reviewed AP1 and AP2, the only new information below will be the staff comments and the questions (both of which appear in white boxes).

6. 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.

7. Neither this agenda paper nor AP1 includes any disclosure issues. As the objective of AP2 is to set out the main problems identified by field test entities, it includes a few disclosure issues; however these are not incorporated in Agenda Paper 3. All disclosure issues from comment letters and field test reports are combined and covered separately in Agenda Paper 4.

Organisation of the Issues

8. The sequencing of the issues in this Agenda Paper corresponds predominantly to the organisation in AP1, that is:

   a. General issues relating to questions in the Invitation to Comment in the ED – not related to a particular section in the ED (starts at paragraph 9).

   b. Other general issues in the comment letters/field tests – not related to a specific section in the ED (starts at paragraph 11).

   c. Issues raised in the comment letters/field tests that relate to a specific section in the ED (starts at paragraph 21).

   d. Adequacy of guidance – a list comprising suggestions for additional guidance and also problems encountered during the field testing that suggest further guidance would be helpful (starts at paragraph 58).

Issues Relating to Questions in the Invitation to Comment in the ED

9. **Stand-alone IFRS for SMEs (Question 1). [AP1.21].** Over 60% of the comment letters that addressed the 'stand-alone' issue would eliminate all 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. Two options:

    a. Eliminate all cross-references to full IFRSs, including those relating to accounting policy options (optional cross-reference to the more complex option) and omitted topics (mandatory cross-reference if the SME encounters the situation)? Address omitted topics and policy options as in the table below.

    b. Keep the number of cross-references to an absolute minimum? Address omitted topics and policy options as in the table below.

FT [AP2.27&80] – Make IFRS for SMEs stand-alone

- 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.
- 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.

To what extent should the IFRS for SMEs be a stand-alone document?

a. Eliminate all cross-references to full IFRSs.

b. Eliminate most cross-references to full IFRSs.

Either way, what to do about each of the following?

Para	IFRS	Cross-Reference: Accounting Policy Options:	Address but simplify from full IFRS	Do not address in IFRS for SMEs	Keep cross-ref
7.9	IAS 7	Option to use direct method for cash flows from operating activities under IAS 7			
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)			
13.5	IAS 28	Option to follow equity method and disclosures for associates under IAS 28			
14.10	IAS 28 and IAS 31	Option to follow equity method and disclosures for jointly controlled entities under IAS 28 (via IAS 31)			
14.11	IAS 31	Option to follow proportionate consolidation method and disclosures for jointly controlled entities under IAS 31			
15.5	IAS 40	Option to follow fair value model and disclosures for investment property under IAS 40			
16.13	IAS 16	Option to follow revaluation model and disclosures for PPE under IAS 16			
17.16	IAS 38	Option to follow capitalisation model for research and development under IAS 38			
17.23	IAS 38	Option to follow revaluation model and disclosures for intangible assets under IAS 38			

Para	IFRS	Cross-Reference: Accounting Policy Options:	Address but simplify from full IFRS	Do not address in IFRS for SMEs	Keep cross-ref
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.			
24.4, 24.5	IAS 23	Option to use capitalisation model and disclosures for borrowing costs under IAS 23			

Para	IFRS	Cross-Reference: Omitted topics:	Address but simplify from full IFRS	Do not address in IFRS for SMEs	Keep cross-ref
19.15	IAS 17	Omitted guidance - lessor in a finance lease refers to guidance and disclosures under IAS 17			
25.4	IFRS 2	Omitted guidance - for equity settled share based payments refer to measurement and disclosures under IFRS 2.			
25.7	IFRS 2	Omitted guidance - for share based payment transactions with cash alternatives refer to guidance under IFRS 2.			
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.			
31.1	IFRS 8	Omitted guidance - entities wishing to produce segment information refer to IFRS 8.			
34.1	IAS 33	Omitted guidance - entities wishing to produce earnings per share refer to IAS 33			
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.			
35.3	(IFRS 4)*	Omitted guidance - entities who are insurers are outside scope of IFRS for SMEs			
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			

10. **Anticipating changes to full IFRSs. [AP1.29]** 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, except for those grants related to assets at fair value through profit or loss, 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 should 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.

Staff comment: In response to the foregoing comment, possible approaches would be:

a. As a matter of policy, the IFRS for SMEs should not anticipate possible changes to full IFRSs. Therefore:

- Allow all of the options for deferring and spreading actuarial gains and losses that are in IAS 19.*
- Allow all of the exceptions to recognition of deferred taxes that are in IAS 12.
- Limit the requirement to apply the IFRS for SMEs model of accounting for government grants to agricultural assets that will be measured at fair value through profit or loss. (The IFRS for SMEs model is the one required by IAS 41 *Agriculture*.)

b. Each situation should be considered on its own merits (in the same way as any simplification to full IFRSs when developing the IFRS for SMEs), rather than as a comprehensive policy.

*Later in this agenda paper, paragraph 23(b) discusses a related issue – whether to conform Section 3 *Financial Statement Presentation* of the IFRS for SMEs to the newly revised IAS 1. Revised IAS 1 requires presenting a statement of comprehensive income either instead of, or in addition to, an income statement. Currently, IAS 19 allows actuarial gains and losses to be recognised when they arise and to be reported outside of profit or loss in the statement of comprehensive income. Section 27 *Employee Benefits* of the IFRS for SMEs does not currently permit that. If Section 3 is conformed to the revised IAS 1, then another option to be given to SMEs would probably be immediate recognition of actuarial gains and losses as income or expenses to be presented outside of profit or loss in the statement of comprehensive income.

Should the IFRS for SMEs anticipate changes to full IFRSs, or should it be based on IFRSs as adopted at the time the IFRS for SMEs is approved? ***If at least some changes should be anticipated, what to do about each of the following:***	
Elimination of the corridor approach for deferring and spreading actuarial gains and losses.	
Elimination of certain exceptions in IAS 12 to recognition of deferred taxes.	
Replacement of the variety of options in IAS 20 by a single method of accounting for all government grants.	

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

11. **Name for SME [AP1.31].** 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 applicability 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')

FT [AP2.31&32] – Problems applying the definition of an SME.

- It's better to use a different term than SME, for example "Private Entities". The word SME causes confusion as it excludes larger entities.
- Confusion since the definition of SME is inconsistent with the definition of SME in a particular jurisdiction.
- 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.
- 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.
- Give quantitative requirements for SMEs.
- Remove reference to 50 employees (BC45).

Staff comment: ED paragraphs 1.1 and 1.2 define the scope of applicability of the IFRS for SMEs as follows:

1.1 The IFRS for SMEs is intended for use by small and medium-sized entities (SMEs). SMEs are entities that:

(a) do not have public accountability; and

(b) publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

1.2 An entity has public accountability if:

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

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

There are two questions related to this issue. The first concerns whether the Board's description of the entities allowed to use the IFRS for SMEs is appropriate (entities that do not have public accountability). The second is whether the name SME should be changed to something else and, if so, what.

Is the Board's description of entities that could be allowed to use the IFRS for SMEs appropriate – namely entities that do not have public accountability? Or, if not, how should the description be changed?

Is the term 'Small and Medium-sized Entity' appropriate to describe the entities that could be allowed to use the IFRS for SMEs and, if not, what is a better term? Possible alternative terms include:

- ***NPAE (non-publicly accountable entity).***
- ***NPIE (non-public-interest entity).***
- ***Private entity***

12. **Scope [AP1.32].** 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 [AP1.32(a)].** 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.

Should the IFRS for SMEs explicitly state that it is not intended to be used by micro entities (fewer than 10 employees) even if those entities produce GPFS? If yes, why, and which standards would a micro that prepares GPFS follow?

b. **Three-tier approach [AP1.32(b)].** 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.

FT [AP2.32(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.

Should the IASB consider developing a very simple set of standards (a third tier) for micros?

c. **Small listed entities [AP1.32(c)].** 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.

Staff Comment: Paragraph 1.3 of the ED states:

1.3 If a publicly accountable entity uses this [draft] standard, its financial statements shall not be described as conforming to the *IFRS for SMEs*—even if national law or regulation permits or requires this [draft] standard to be used by publicly accountable entities.

FT [AP2.32(f)]

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

Should the IASB allow jurisdictions to decide whether to permit or require small listed entities to use the IFRS for SMEs? (Or perhaps limit this option to entities that are publicly traded in developing countries or emerging markets.)

If yes, how should IFRS for SMEs define "small listed entities"?

d. **Entities that receive funds in a fiduciary capacity [AP1.32(d)].** 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).

FT [AP2.32(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.

Staff Comment: In English, "fiduciary" means "of, pertaining to, or involving one who holds something in trust for another" or, simply, "held in trust".

Should individual jurisdictions decide whether unlisted financial institutions should be required or permitted to use the IFRS for SMEs?

Should the IASB clarify that the concept 'fiduciary capacity' excludes:

a. Entities that receive funds in a fiduciary capacity as a sideline, such as travel agencies and utilities?

b. Mutual or venture capital funds with a limited number of owners?

c. Other exclusions?

e. **Special exemptions within the IFRS for SMEs [AP1.32(e)].** 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.

Should the IASB include, in the IFRS for SMEs, special exemptions from some requirements for entities at the small end of the SME spectrum? **[Staff comment: WG members please address this both as a policy issue and, if possible, with suggestions for specific exemptions.]**

13. **Restatements [AP1.33].** 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.

Staff comment: The IFRS for SMEs would require restatements for:

a. Consistency of presentation (3.10, with impracticability exemption)

b. Corrections of prior period errors (10.20, but 10.21 has an exemption for impracticability)

c. Changes in accounting policy (10.9, with impracticability exemption)

d. Discontinued operations (36.3, with impracticability exemption)

e. Reclassification of assets as held for sale (36.4)

f. First-time adoption of the IFRS for SMEs (38.5, with impracticability exemption in 38.9)

Staff comment, continued: Impracticable is defined as follows: "Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so." The definition does not include an undue cost or effort principle. Note that the definition of impracticable is used in the IFRS for SMEs for circumstances other than exemption from restatement, for instance, for exemption from measuring assets and liabilities at fair value.

Should any of the requirements for restatement in cases (a) through (f) above be changed in the IFRS for SMEs, and, if so, how?

Should an "undue cost or effort" principle be added to the definition of impracticable for the purpose of deciding on restatement in any of cases (a) through (f) above? **[Staff comments: "impracticable is used in a number of sections of the IFRS for SMEs, so changing the definition will have consequences beyond restatements. Also the question following paragraph 14(a) below also relates to an "undue cost or effort" exemption.]**

14. **Fair value – general [AP1.34].**

   a. As a general principle, restrict use of fair value to:

      i. 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

      ii. All derivatives.

Staff comment: The same issue arose in comments on the concepts and pervasive principles in Section 2 (see paragraph 22(a) and 22(b) below). And also in comments on Section 11 *Financial Assets and Financial Liabilities* (see paragraph 32(a) below). Staff suggests that these paragraphs be discussed together.

Here is a list of various criteria that have been proposed for when fair value is appropriate (plus all derivatives). These are not mutually exclusive (that is, a FV requirement could include two or more of these). Nor are they necessarily determinative (if criterion is met, FV measurement is automatically required):

- Assets that the entity intends to dispose of or transfer.
- Assets and liabilities that are 'readily realisable'.
- Assets and liabilities whose FV is 'objectively determinable' from 'observable market prices'.
- Assets and liabilities whose for which there is an active market.
- Assets and liabilities whose FV is determinable without undue cost or effort.

FT [AP2.23] – 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.
- 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.

Should an "undue cost or effort" exemption be added for some or all requirements for fair value measurement and, if so, which ones? For instance, would such an exemption apply only to financial instruments or also to non-financial assets and liabilities? [ED Section 35 includes such an exemption for biological assets.] Would it apply to derivative financial instruments? Would it apply to measurement of impairment losses (ED Section 26)? Would it apply to fair value measurements at both initial recognition and subsequent measurement?

What criteria should be required for non-derivative assets or liabilities to be measured at fair value?. Answer this question as a matter of general measurement principle – applicability of the principle will need to be considered case by case. A way to think about it is to say which of the following criteria, if NOT met, should prevent fair value measurement:

- ***Assets that the entity intends to dispose of or transfer.***
- ***Assets and liabilities that are 'readily realisable'.***
- ***Assets and liabilities whose FV is 'objectively determinable' from 'observable market prices'.***
- ***Assets and liabilities for which there is an active market.***
- ***Assets and liabilities whose FV is determinable without undue cost or effort.***

b. 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.

Should the term 'fair value' be replaced and if so, how (for example with 'current value')?

15. 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. **[AP1.35]**
16. **Structure of the standard [AP1.36].** 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).

17. 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.). **[AP1.37]**

FT [AP2.25&27] – Simplify language and improve structure

- 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.
- Several field test entities commented that overall the language in the ED could be simplified.

Should any changes be made to the structure 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, orient structure more to the balance sheet?

18. **Post-issuance assessment and ongoing reviews of the IFRS for SMEs (Question 11) [AP1.38].** 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 paragraphs BC125–BC127). 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.

Should the Board undertake a special post-issuance assessment one or two years after the IFRS for SMEs takes effect (a more comprehensive review than the anticipated biannual 'maintenance' reviews)?

Regarding the anticipated 'maintenance' reviews for ongoing updates, should the review cycle be longer than two years?

19. **Interpretations of the IFRS for SMEs [AP1.39].** 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.

20. 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. **[AP1.40]**

What is the best way for the IASB to provide guidance for implementing the IFRS for SMEs?

a. Will the training materials approach do the job, coupled with locally developed guidance for local issues?

b. Should the IASB either develop a formal process for considering interpretations of the IFRS for SMEs (including 'rejection notices' similar to IFRIC's) or, at least, explain its thinking in this regard?

Issues Related to a Specific Section in the ED

21. **Use by a subsidiary of an IFRS company (Section 1) [AP1.46].** Clarify use of the 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.

Staff comment: Most of the recognition and measurement simplifications proposed in the ED are optional. There are only a limited number of mandatory recognition and measurement differences in the ED. The principal ones are:

a. Recognition of actuarial gains and losses in full in profit or loss when they occur.

b. Recognition of pension past service cost in full in profit or loss when they occur.

c. Measurement of finance leases at the fair value of the leased property.

d. Measurement of impairment at the fair value of the impaired asset (no value-in-use calculation).

e. Recognising deferred taxes on (i) initial recognition of assets and liabilities and (ii) undistributed earnings of domestic subsidiaries, branches, associates, and joint ventures.

f. Measuring at fair value all grants relating to assets that will be carried at fair value through profit or loss.

If there are recognition or measurement differences in IFRS for SMEs, should a subsidiary of an IFRS entity be allowed use the recognition and measurement principles in full IFRSs but make only the disclosures required by IFRS for SMEs, in its published general purpose financial statements?

A similar issue arises if an entity chooses the more complex option by cross-reference to an IFRS – in that case the full disclosures required by that IFRS are also required. Should some lesser disclosures be required if the SME is a subsidiary of a full IFRS reporting entity?

22. **Concepts and pervasive principles (Section 2) [AP1.47].** Earlier in this Agenda Paper, beginning in paragraph 14, 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 [AP1.47(a)].** (See paragraph 14 above for related issue.) In the pervasive principle 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 [AP1.47(b)].** (See paragraph 14 above for related issue.) 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.

FT [AP2.33] – Fair value 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.

Staff comment: The same issue arose as a general comment on the Exposure Draft (see paragraph 14(a) above). And also in comments on Section 11 *Financial Assets and Financial Liabilities* (see paragraph 32(a) below). Suggest WG discuss paragraph 14(a), paragraph 22 (a) and (b), and paragraph 32(a) together.

c. **Stewardship [AP1.47(c)].** 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.

Should reporting on management's stewardship of the resources entrusted to it be given more importance as an objective of SME financial statements and, if so, how?

d. **Qualitative characteristics [AP1.47(d)].**

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

Staff comment: Under the Framework in full IFRSs, the hierarchy is as follows:

- Understandability
- Relevance
  - Materiality
- Reliability
  - Faithful representation [this is not in SME ED because it is part of the definition of reliability rather than a separate characteristic]
  - Substance over form
  - Neutrality [this is not in SME ED because reliability is defined, in part, as freedom from bias, which is the same as neutrality]
  - Prudence
  - Completeness
- Comparability

Constraints on relevant and reliable information:

- Timeliness
- Balance between benefit and cost

Should the qualitative characteristics of SME financial statements be organised in a hierarchy like the one used in the full IFRS Framework (that is, certain characteristics are identified as principal characteristics)?

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

Should neutrality be added as a qualitative characteristic of SME financial statements, or does the description of reliability in paragraph 2.5 cover it?

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

Should 'full disclosure' be a qualitative characteristic of SME financial statements, or does the description of completeness in paragraph 2.8 cover it?

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

Should faithful representation be added as a qualitative characteristic of SME financial statements, or does the description of reliability in 2.5 cover it? Note that 2.5 defines reliability as "represents faithfully that which it either purposes to represent or could reasonably be expected to represent".

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

Should prudence be replaced with freedom from bias?

e. **Subsequent measurement principles [AP1.47(e)].** 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 paragraph 16 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.

Are the pervasive subsequent measurement principles in 2.41 to 2.44 useful? Or should subsequent measurement be discussed only in the individual sections? Note that this would also affect the hierarchy in paragraphs 10.2–10.4 of Section 10.

f. **Subsequent measurement [AP1.47(f)].** 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.

Should the IASB consider 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 [AP1.47(g)].** 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.

Staff comment: 2.31 is part of the concepts in the IFRS for SMEs (taken from the IASB Framework). It is not one of the pervasive measurement principles. The IASB Framework has the following:

100 A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:

(a) Historical cost. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) Current cost. Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) Realisable (settlement) value. Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) Present value. Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Note that it is generally agreed that present value is not a measurement basis but a technique for measuring one of the other bases. Current cost, while mentioned in the Framework, is not used in standards. Realisable value is used in the context of inventories. In the IFRS for SMEs we use “selling price less costs to complete and sell.”

2.31 only lists two common measurement bases: historical cost and fair value. Should the IFRS for SMEs identify other common measurement bases in Section 2?

h. **Fair presentation [AP1.47(h)].** 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.

Staff comment: The ED states the following:

2.1 The objective of financial statements of a small or medium-sized entity is to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. In meeting that objective, financial statements also show the results of management's stewardship of the resources entrusted to it.

Should Section 2 describe or define what is 'fair presentation' for an SME?

Should fair presentation (or 'true and fair presentation') of financial statements be added to Section 2 as an objective?

i. **Tax and distributable income [AP1.47(i)].** Add determination of taxable income and distributable income as objectives (see BC28 to BC30).

Should determination of taxable income and distributable income be objectives of the financial statements of an SME? If yes, how could the IFRS for SMEs take account of differing national laws and regulations?

j. **User needs [AP1.47(j)].** Put more discussion of user needs in this Section. (Staff notes that that it is now discussed in BC23 to BC26.)

Staff comment: Here are those four paragraphs from the Basis for Conclusions:

Different users' needs and cost-benefit considerations

BC23 The Framework (paragraph 12) states:

> The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

In establishing standards for the form and content of general purpose financial statements, the needs of users of financial statements are paramount.

BC24 Users of financial statements of SMEs may have less interest in some information in general purpose financial statements prepared in accordance with full IFRSs than users of financial statements of entities whose securities are listed for trading in public securities markets or that otherwise have public accountability. For example, users of financial statements of SMEs may have greater interest in short-term cash flows, liquidity, balance sheet strength and interest coverage, and in the historical trends of earnings and interest coverage, than they do in information that is intended to assist in making forecasts of an entity's long-term cash flows, earnings and value. However, users of financial statements of SMEs may need some information that is not ordinarily presented in the financial statements of listed entities. For example, as an alternative to the public capital markets, SMEs often obtain capital from shareholders, directors and suppliers, and shareholders and directors often pledge personal assets so that the SME can obtain bank financing.

BC25 In the Board's judgement, the nature and degree of the differences between full IFRSs and an IFRS for SMEs must be determined on the basis of users' needs and cost-benefit analyses. In practice, the benefits of applying accounting standards differ across reporting entities, depending primarily on the nature, number and information needs of the users of their financial statements. The related costs may not differ significantly. Therefore, consistently with the Framework, the Board believed that the cost-benefit trade-off should be assessed in relation to the information needs of the users of an entity's financial statements.

BC26 The Board faced a dilemma in deciding whether to develop an IFRS for SMEs. On the one hand, it believed that the same concepts of financial reporting are appropriate for all entities regardless of public accountability—particularly the concepts for recognising and measuring assets, liabilities, income and expenses. This suggested that a single set of accounting standards should be suitable for all entities, although it would not rule out disclosure differences based on users' needs and cost-benefit considerations. On the other hand, the Board acknowledged that differences in the types and needs of users of SMEs' financial statements, as well as limitations in, and the cost of, the accounting expertise available to SMEs, suggested that separate standards for SMEs are appropriate. Those separate standards could include constraints such as linkage back to the Framework, consistent definitions of elements of financial statements and focus on the needs of users of financial statements of SMEs. On balance, the Board concluded that the latter approach (separate standards) was appropriate.

Should more discussion of user needs be added to Section 2? If yes, does the discussion in BC23 to BC26 cover the relevant points and should it be moved into Section 2?

23. **Financial statement formats (Sections 3-8) [AP1.48].**

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.

FT [AP2.37] – 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.

Should the IFRS for SMEs prescribe financial statement formats, subtotals, minimum line items, sequencing, and note disclosures with more specificity than in the ED?

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.

Staff comment: IAS 1 (revised 2007) requires:

- Present all non-owner changes in equity (that is, 'comprehensive income') either in (a) one statement of comprehensive income or (b) in two statements (a separate income statement and a statement of comprehensive income). Components of comprehensive income may not be presented in the statement of changes in equity. Under the IFRS for SMEs, the only components of comprehensive income that are not part of profit or loss are (a) changes in revaluation surplus (for an SME that chooses to use the revaluation option in Section 16 and Section 17); (b) gains and losses arising from translating the financial statements of a foreign operation (Section 30); and (c) the effective portion of gains and losses on hedging instruments in a highly probable forecast transaction (Section 11).
- Present a statement of financial position (balance sheet) as at the beginning of the earliest comparative period in a complete set of financial statements when the entity applies an accounting policy retrospectively or makes a retrospective restatement.
- Disclose income tax relating to each component of other comprehensive income.
- Disclose reclassification adjustments relating to components of other comprehensive income.
- Changes the titles of financial statements (as they will be used in the IFRS for SMEs) as follows (but SMEs would be permitted to use other appropriate titles):
    - ‘balance sheet’ changes to ‘statement of financial position’
    - ‘income statement’ changes to ‘statement of comprehensive income’
    - ‘cash flow statement’ changes to ‘statement of cash flows’

Should the IFRS for SMEs incorporate the above new IAS 1 requirements?

– Statement of comprehensive income (instead of or in addition to an income statement)?

– Third balance sheet in cases of restatement?

– Intra-period tax allocation?

– Disclosures about reclassifications?

– New titles of financial statements?

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

Should the IFRS for SMEs require standardised titles for financial statements?

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

Should the IFRS for SMEs require two prior years of comparative data?

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

Should the IFRS for SMEs require a current/non-current balance sheet 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.

FT [AP2.36] – 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.

Should the current/non-current distinction always be 12 months?

g. Require analysis of expenses by nature for all SMEs, for comparability and usefulness (see 5.8 of the ED). Function is somewhat arbitrary and not comparable from company to company. If choice is retained, do not require disclosure of the additional information that ED 5.10 proposes [at least depreciation and amortisation expense and employee benefits expense] if function is chosen.

FT [AP2.38&39(b)] – "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.
- Some entities noted that the "by function" presentation of the income statement is impracticable due to the need to segregate distribution and administration expenses

Should the IFRS for SMEs require analysis of expenses by nature for all SMEs?

If choice is retained, should IFRS for SMEs continue to require disclosure of additional information (including depreciation and amortisation and employee benefits expense) if function is chosen (ED paragraph 5.10)?

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

Should a line item for changes in fair value (if required to be recognised in P&L) be added to the income statement requirements?

i. Do not allow a combined statement of income and retained earnings (see paragraph 6.4 of the ED). 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.

FT [AP2.41] – 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.

Should a combined statement of income and retained earnings be permitted or should all SMEs be required to prepare an equity statement in addition to an income statement (and possibly a statement of comprehensive income)?

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.

FT [AP2.42] – Reasons for non-preparation of statement of changes in equity

- 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.)

Should a statement of changes in equity be required?

24. **Statement of cash flows (Section 7) [AP1.49].**

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

FT [AP2.44] – Choice of presentation of operating cash flows

- 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.

Should the direct method be permitted? Required? Prohibited?

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.

FT [AP2.45] – Reasons for non-preparation of cash flow 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.

Should a cash flow statement be required? Optional? Left for jurisdictions to decide?

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

Should an SME classify all cash flows from income taxes as operating?

25. **Disclosures (Section 8) [AP1.50].** As noted earlier, disclosure issues raised by respondents are discussed in Agenda Paper 4.

26. **Consolidation (Section 9) [AP1.51].**

    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.

FT [AP2.49&50] – Reasons for non-preparation of consolidated statements

- 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 require (see Adequacy of Guidance part of this agenda paper starting at paragraph 58 below).
- 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: 1) Absence of reliable information, for example for a subsidiary in liquidation. 2) 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.

Should all SME groups be required to prepare consolidated financial statements? Alternatives:

– Provide exemption based on size of group

– Allow local jurisdiction to decide

– Establish criteria (as in paragraph 26(b) above) for when consolidated financial statements are required

– If the IFRS for SMEs provides for some exemptions, require that all shareholders must agree (ie, the minority interest does not object)

c. Allow a temporary control exemption from consolidation.

Staff comment: IAS 27 has a footnote to paragraph 12 that states:

> * If on acquisition a subsidiary meets the criteria to be classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, it shall be accounted for in accordance with that IFRS.

The IFRS for SMEs does not have a similar exemption.

Should there be an exemption from consolidation if the subsidiary on acquisition meets the criteria to be classified as held for sale (or, alternatively, was acquired with an intention to dispose of it in the short term, say under one year)?

d. Only allow non preparation of consolidated financial statements under 9.2 if the minority interest does not object. 9.2 provides an exemption when the SME parent is, itself, a subsidiary and its ultimate parent publishes consolidated financial statements that comply with full IFRSs or the IFRS for SMEs.

Should the exemption in 9.2 be allowed only if all shareholders agree (ie, the minority interest does not object)?

e. Do not have requirements for combined financial statements (ED paragraphs 9.21-9.22). 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 58).

Should the guidance on combined financial statements in 9.21-9.22 be removed or retained?

27. **Separate financial statements (Section 9) [AP1.52].**

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).

Should different accounting policies be allowed in accounting for different types of investments in separate financial statements?

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.

Should equity method and proportionate consolidation be allowed in separate financial statements to the extent allowed in consolidated financial statements??

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

Should fair value through profit or loss be required in separate financial statements if an active market exists for the subsidiary's shares?

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

Staff comment: Under Section 9 as currently written, when there is a parent-subsidiary relationship only consolidated statements are required – separate company statements are not required.

Should the IFRS for SMEs require separate company financial statements when consolidated financial statements are prepared?

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

Staff comment: This is another way of recommending that consolidation be optional. This is already covered in the question following paragraph 26(b) of this agenda paper.

Accounting Policies Hierarchy (Section 10) – Question 7 in the Invitation to Comment [AP1.53]

28. Of those who responded to Question 7, approximately three-quarters supported the hierarchy proposed in ED 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.

FT [AP2.52(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.

Staff comment: Here are paragraphs 10.2–10.4 from the ED:

10.2 If this [draft] standard does not specifically address a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and

(b) reliable, in that the financial statements:

(i) represent faithfully the financial position, financial performance and cash flows of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects.

10.3 In making the judgement described in paragraph 10.2, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements and guidance in this [draft] standard dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 Concepts and Pervasive Principles.

10.4 In making the judgement described in paragraph 10.2, management may also consider the requirements and guidance in full International Financial Reporting Standards (IFRSs) dealing with similar and related issues. If additional guidance is needed to make the judgement described in paragraph 10.2, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 10.3.

29. 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. **[AP1.54]**

30. 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. **[AP1.55]**

   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. **[AP1.55(a)]**

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. **[AP1.55(b)]**

Is the hierarchy in 10.2 to 10.4 appropriate in principle? If not, how should it be changed?

Even if appropriate in principle, should it be clarified that there is no obligation to look to full IFRSs, and if so how?

31. **Other issues for Section 10 [AP1.56]:**

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.

FT [AP2.52(b)] – Problems making adjustments for errors

- 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.

When an SME is following an option in a full IFRS, and that full IFRS changes, should SMEs automatically be required to follow the transitional provisions in that revised IFRS? Or should SMEs continue to follow the IFRS that was originally cross-referenced until specific amendment of the IFRS for SMEs?

Should retrospective restatement (correction) be required only for 'fundamental' errors (or perhaps 'material' errors)? If so, how should 'fundamental errors' be defined?

Should retrospective restatement be required for a voluntary change in accounting policy or for an error (with an impracticability exception as proposed in the ED). Or should all voluntary accounting policy changes and error corrections be done prospectively on grounds that SMEs do not have the data or the resources to do the retrospective restatements? (See also paragraph 13 of this agenda paper for discussion of restatements.)

When the IASB makes a change to the IFRS for SMEs, should retrospective restatement be required (with an impracticability exception, as proposed in the ED)? Or should SMEs not be required to restate for accounting changes mandated by changes to the IFRS for SMEs, for the same reason as above.

32. **Financial instruments (Section 11) [AP1.57]:**

    a. Make cost the default measurement basis, not fair value. **[AP1.57(a)].**

FT [AP2.56&57] – Fair value requirements require undue cost or effort

- Some field test entities said cost should be the default category, with fair value only rarely applied.
- 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:
- Use of external experts is not financially possible for SMEs.
- Asset base is too small to justify cost of calculating fair value annually.
- Fair value measurements of non-quoted instruments result in undue cost and effort, in excess of benefits.
- No reliable measure of fair value for certain instruments.
- Appendix B, covering fair value measurement, is difficult to understand and often not relevant. Practical examples are necessary.
- 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.
- 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.

Should Section 11 be rewritten to make cost the default measurement basis for financial instruments? If yes, then only those that meet certain criteria will be at fair value through profit or loss; what should those criteria be?

Staff comment: See also the discussion of fair value in paragraph 14 of this agenda paper. Criteria for when fair value should be required are discussed there.

b. Bring back the available for sale (AFS) category **[AP1.57(b)]**.

FT [AP2.57]

- Some field test entities 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.

Staff comment: Under IAS 39, AFS instruments are non-derivative financial instruments that are not loans or receivables, not held-to-maturity investments (HTM), and not financial assets at fair value through profit or loss. Under IAS 39, an instrument that otherwise would meet the definition of HTM or FV through P&L can still optionally be designated to be AFS. Under IAS 39, AFS instruments are measured at fair value through equity, subject to impairment recognition in profit or loss.

Should the AFS category be included in Section 11?

c. Straight-line amortisation of discounts/premiums, not the effective interest method **[AP1.57(c)]**.

FT [AP2.58]

- 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.

Should straight-line amortisation of discounts and premiums be permitted as an alternative to the effective interest method? Required?

d. Hedge accounting **[AP1.57(d)]**:

- Allow a shortcut method for hedging by which, if certain conditions are met, effectiveness could be presumed without a complex calculation.

Staff comment: In BC75, the Board explained why it did not adopt a shortcut method, as follows:

BC75 As an alternative to simplified effectiveness testing, the Board considered an approach that is in the US standard SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* and is called the 'shortcut method'. Under such a method, the *IFRS for SMEs* would impose strict conditions on the designation of a hedging relationship with subsequent hedge effectiveness assumed without need for measuring ineffectiveness. The Board concluded that simplified effectiveness testing is preferable to the shortcut method for two principal reasons:

(a) Recognition of all hedge ineffectiveness in profit or loss is a basic principle of IAS 39. The shortcut method is inconsistent with that principle.

(b) To be able to assume that the possibility of hedge ineffectiveness is nil or insignificant, the key features of the hedging instrument and the hedged item, including the term, would have to match, and there could be no conditional terms. Consequently, hedge accounting would be prohibited if the hedging instrument is prepayable or puttable or has other early termination or extension features. Such a requirement would, in effect, make hedge accounting a practical impossibility for many, and perhaps most, SMEs.

- Guidance for measuring hedge effectiveness should be within Section 11, not in the Basis for Conclusions.

Staff comment: There is limited discussion of measuring hedge effectiveness in BC74, BC75, and BC76. But staff does not view this as substantive guidance on measuring hedge effectiveness.

BC74 With regard to hedge accounting, the draft *IFRS for SMEs* would require periodic recognition and measurement of hedge ineffectiveness, but under less strict conditions than those in IAS 39. In particular, ineffectiveness is recognised and measured at the end of the financial reporting period, and hedge accounting is discontinued prospectively starting from that point, for hedges that no longer meet the conditions for hedge accounting. IAS 39 would require discontinuation of hedge accounting prospectively starting at the date the conditions were no longer met—a requirement that SMEs often say they find burdensome.

BC75 As an alternative to simplified effectiveness testing, the Board considered an approach that is in the US standard SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* and is called the 'shortcut method'. Under such a method, the *IFRS for SMEs* would impose strict conditions on the designation of a hedging relationship with subsequent hedge effectiveness assumed without need for measuring ineffectiveness. The Board concluded that simplified effectiveness testing is preferable to the shortcut method for two principal reasons:

(a) Recognition of all hedge ineffectiveness in profit or loss is a basic principle of IAS 39. The shortcut method is inconsistent with that principle.

(b) To be able to assume that the possibility of hedge ineffectiveness is nil or insignificant, the key features of the hedging instrument and the hedged item, including the term, would have to match, and there could be no conditional terms. Consequently, hedge accounting would be prohibited if the hedging instrument is prepayable or puttable or has other early termination or extension features. Such a requirement would, in effect, make hedge accounting a practical impossibility for many, and perhaps most, SMEs.

BC76 Section 11 also differs from IAS 39 with respect to hedge accounting in the following ways:

(a) Hedge accounting cannot be achieved by using debt or equity instruments ('cash instruments') as hedging instruments. IAS 39 permits this for a hedge of a foreign currency risk. However, the same effect on profit or loss can be achieved by measuring the cash instrument at fair value, which Section 11 requires for some cash instruments and permits for others. SMEs typically sell the cash hedging instrument when the hedging relationship terminates.

(b) Hedge accounting cannot be achieved with an option-based hedging strategy. Because hedging with options involves incurring a cost, SMEs are more likely to use forward contracts as hedging instruments rather than options.

(c) Hedge accounting for portfolios is not permitted. Hedging portfolios adds considerable accounting complexity because of the need to remeasure all of the hedged items individually at fair value to ensure that the appropriate amounts are derecognised when the instrument is sold and to ensure that the amortisation is appropriate when an instrument is no longer being hedged.

The Board does not believe that these simplifications will affect SMEs adversely because these are not hedging strategies that are typical of SMEs.

- Simplify hedging documentation.

Staff comment: Here are the requirements of 11.30:

11.30 To qualify for hedge accounting, an entity shall comply with all of the following conditions:

(a) the entity designates and documents the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified and the risk in the hedged item is the risk being hedged with the hedging instrument.

(b) the hedged risk is one of the risks specified in paragraph 11.31.

(c) the hedging instrument is as specified in paragraph 11.32.

(d) the entity expects the hedging instrument to be highly effective in offsetting the designated hedged risk. The **effectiveness of a hedge** is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

FT [AP2.59&63] – Problems with hedging requirements

- 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:
- 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.
- 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.
- More guidance, with examples, should be provided for hedge accounting.

Should a short-cut method be allowed for hedge accounting?

Should Section 11 include specific guidance on how to measure hedge effectiveness? Or is this something better left to training materials?

Should the hedging documentation requirement of ED 11.30 be simplified and, if so, how?

e. Allow purchased options and debt instruments as hedging instruments **[AP1.57(e)]**.

FT [AP2.60]

- 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.

Staff comments: Here is paragraph 11.31:

11.31 This [draft] standard permits hedge accounting only for:

(a) interest rate risk of a debt instrument measured at amortised cost;

(b) foreign exchange or interest rate risk in a firm commitment or a highly probable forecast transaction;

(c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or

(d) foreign exchange risk in a net investment in a foreign operation.

Should purchased options and debt instruments be permitted as hedging instruments? (They are generally not permitted under IAS 39.)

Should SMEs be permitted to use hedge accounting for types of risks in addition to those in 11.31 and, if so, which types of risks?

f. Clarify what is required for derivatives and embedded derivatives **[AP1.57(f)]**. Respondents noted that the scope requirements for leases and insurance contracts ED 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.

Should guidance be added regarding derivatives and embedded derivatives?

g. Add guidance on factoring and similar transactions **[AP1.57(g)]**.

FT [AP2.63]

- More guidance, with examples, should be provided for debt factoring.

Should guidance be added on accounting for 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 **[AP1.57(h)]**.

Staff comment: The Board's reasons for allowing the choice of IAS 39/IFRS 7 in full are set out in paragraph BC78 as follows:

BC78 Section 11 proposes to give SMEs a choice of following Section 11 or IAS 39 in accounting for all of their financial instruments. The Board's reasons for proposing that choice in this case are as follows:

(a) Although Section 11 is a simpler approach to accounting for financial instruments than IAS 39, some of the simplifications involve eliminating options that are available to companies with public accountability under IAS 39, for instance:

(i) available-for-sale classification and the available-for-sale option;

(ii) held-to-maturity classification;

(iii) a continuing involvement approach to derecognition (ie partial derecognition); and

(iv) the use of hedge accounting for hedges other than the four specific types identified in paragraph BC73(c).

In general, the draft *IFRS for SMEs* would permit SMEs to have the same accounting policy options as in full IFRSs.

(b) Because the proposed default category for financial instruments is fair value through profit and loss under the *IFRS for SMEs*, and cost or amortised cost is permitted only when specified conditions are met, some items measured at cost or amortised cost under IAS 39 because of their nature would be measured at fair value through profit or loss under the *IFRS for SMEs*. Some SMEs might find this added fair valuation burdensome.

(c) Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. Those entities generally believe that the available-for-sale classification of IAS 39 is appropriate to account for strategic investments. Under the draft *IFRS for SMEs*, however, these strategic investments would be accounted for at fair value through profit or loss.

(d) The derecognition provisions of the draft *IFRS for SMEs* would not result in derecognition for many securitisations and factoring transactions that SMEs may enter into, whereas IAS 39 would result in derecognition.

Should SMEs be permitted to follow IAS 39 in full (and IFRS 7) instead of following Section 11? (See also paragraph 9 regarding which options should remain in the IFRS for 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) **[AP1.57(i)]**.

j. Additional field test issue:

FT [AP2.61] – Difficulties with impairment requirements

- 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:
- 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.
- 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).
- 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")

Staff comment: Here are the requirements of 11.22 (and 11.7) of the ED:

11.22 An entity shall measure an impairment loss as follows:

(a) for an instrument measured at amortised cost less impairment in accordance with paragraph 11.7(a), the impairment loss is the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate; and

(b) for an instrument measured at cost less impairment in accordance with paragraph 11.7(b) and (c), the impairment loss is the difference between the asset's carrying amount and the asset's fair value.

11.7 At each reporting date, an entity shall measure the following financial instruments at cost or amortised cost less impairment, as indicated:

(a) an instrument (such as a receivable, payable, or loan) that meets the conditions of paragraph 11.9, and that the entity designates at initial recognition to be measured at amortised cost (using the effective interest method) less impairment. Appendix A to this section provides guidance on applying the effective interest method.

(b) a commitment to make or receive a loan that:

(i) cannot be settled net in cash,

(ii) when executed, is expected to meet the conditions for recognition at cost or amortised cost less impairment, and

(iii) the entity designates at initial recognition to be measured at cost less impairment.

(c) equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably, and contracts linked to such instruments that, if exercised, will result in delivery of such instruments, which shall be measured at cost less impairment.

Is the requirement in 11.22(a) appropriate for measuring the impairment of an instrument (such as a receivable or loan) that the entity designates at initial recognition to be measured at amortised cost (using the effective interest method) less impairment?

Should the IASB remove the reference to fair value in 11.22(b) regarding the impairment measurement requirements for instruments under 11.7(e) (e.g. equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably)? If so, how should the impairment test be performed for these instruments?

k. Additional issue: Commentators have suggested splitting Section 11 into two sections roughly along the following lines:

   i. One would deal only with "plain vanilla" financial instruments – such as cash, bank deposits, accounts receivable, accounts payable, normal loans payable, bad debts, factoring, and related disclosures.

   ii. The other would deal with all of the other issues, including investments, bonds, asset backed securities, options, warrants, futures, forwards, swaps, derecognition, hedge accounting, and related disclosures.

What are the views of WG members on splitting Section 11 along the lines described above?

33. **Inventories (Section 12) [AP1.58]:**

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

Should SMEs be permitted to measure all of their inventory at the most recent prices?

b. Allow LIFO as an inventory costing method.

Should SMEs be permitted to use LIFO (it is prohibited under IAS 2)?

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

FT [AP2.64] – 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.

Should inclusion of non-production overheads in inventory be optional for SMEs?

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

Staff comment: Only the following paragraphs from IAS 2 are not in the IFRS for SMEs:

- IAS 2.8, which elaborates on what are inventories.
- IAS 2.17, which explains that IAS 23 allows inclusion of borrowing costs as part of inventory cost in limited circumstances. This was omitted because the default under the IFRS for SMEs is to charge borrowing cost to expense.
- Paragraphs IAS 2.26 and IAS 2.27, which are guidance on applying cost formulas.
- IAS 2.28 to IAS 2.33 on net realisable value. This issue is included in Section 26, which deals comprehensively with impairment of non-financial assets.

Otherwise, all of IAS 2 is included.

Should any of the paragraphs in the box above be added to Section 12?

34. **Associates and joint ventures (Section 13 and 14) [AP1.59].** 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.

FT [AP2.66&67] – 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.
- Very few field test entities have jointly controlled entities, and those that do are generally part of large groups.
- Regarding both associates and jointly controlled entities - 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, but feel all options should be fully explained in the IFRS for SMEs.

Staff comment: Items (a) through (e) in paragraph 34 above all relate to the method(s) of accounting for associates and joint ventures that respondents think should be available to SMEs. Under the ED, cost, equity method, and fair value through profit or loss are all options for associates. Those three plus proportionate consolidation are all options for joint ventures. Under the ED, an SME would be required to adopt a single method for all associates and a single method for all JVs. See also paragraph 35(a) below, which notes that some respondents propose that the IFRS for SMEs establish a hierarchy for these methods (ie, which method is most appropriate in which circumstances),

Would WG members restrict the use of any of the methods, and if so which one(s)?

Should the equity method be required for all associates and JVs but simplified from the equity method as described in IAS 28?

Should SMEs be permitted to choose a different method for non-publicly traded investments from their choice for publicly traded investments?

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

Should the maximum three month differential (from IAS 28) be extended for SMEs using the equity method?

35. Other proposals made in the comment letters **[AP1.60]**:

   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.

Staff comment: This point probably is best discussed as part of the discussion of (a) through (e) in the preceding paragraph.

   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).

Should the concepts of associates and jointly controlled entities be dropped from the IFRS for SMEs, and instead cover those investments under Section 11?

36. **Investment property (Section 15) [AP1.61].** 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.

FT [AP2.68] – 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.

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.

FT [AP2.69(a)]
- Classifying leasehold property as investment property causes problems.

f. Additional field test issue:

FT [AP2.69(b)] – Separating mixed use property

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

What are the WG members' views on the above proposals:

a. ***For SMEs, should changes in fair value of investment property go to equity, and if so why?***

b. ***Should SMEs have an option not to separate a lease of land and buildings if classified as investment property and the entity uses the fair value through profit or loss model, and if so why?***

c. ***Should SMEs be prohibited from using the fair value model for reasons of complexity and lack of comparability (or other reasons)?***

d. ***Should the IFRS for SMEs have a single revaluation model for all non-financial assets, not different methods for property, plant and equipment and investment property? If so, which model, and why?***

e. ***Should the option to classify property held under an operating lease as investment property be removed for SMEs?***

f. ***Should SMEs have an option not to separate mixed use property between investment property and property plant and equipment in certain cases. If so, when and why?***

37. **Property, plant and equipment (Section 16) [AP1.62].**

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

FT [AP2.72(c)]

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

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.

FT [AP2.70] – Review of residual values and useful lives

- 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:
- Residual value can be hard to estimate and it's questionable whether this has benefits in the financial statements of small entities.
- Active markets do not exist for certain assets / in certain jurisdictions.
- Residual value is not relevant to a long term point of view.
- Local tax law presumes zero residual value for tax depreciation purposes.

c. Do not allow SMEs to revalue PP&E, that is, remove this option. (covered in stand-alone discussion – see paragraph 9 above).

FT [AP2.71] – 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.

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

e. Additional field test issue:

FT [AP2.72(b)] – Do not capitalise costs associated with a maintenance visit

- 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.

Should component depreciation be required for SMEs?

What should the IFRS for SMEs require regarding periodic review of residual value, useful life, and depreciation method? Less frequent than annual? Reassess only if there is a clear indication of change?

Should the option to revalue PP&E be removed from the IFRS for SMEs? (Also see paragraph 9 regarding options.)

Should an undue cost exemption be added for separation of land and buildings?

Should the IFRS for SMEs require that costs of replacement parts that provide incremental future benefits be capitalised by SMEs?

38. **Intangible assets other than goodwill (Section 17) [AP1.63].**

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

FT [AP2.75(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.

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

FT [AP2.74]

- 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 *Intangible Assets* in order to use the capitalisation model is problematic.

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

FT [AP2.75(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. Do not allow SMEs to revalue any intangibles, that is, remove the option (covered in standalone discussion – see paragraph 9 above).

FT [AP2.73]

- 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 in order to do so. Several field test entities stated that a revaluation option for intangibles is unnecessary.

Should SMEs be required to distinguish between intangible assets with finite and indefinite useful lives, or should amortisation be the policy for all intangibles? If amortisation is to be reintroduced, what should the IFRS for SMEs require regarding method and amortisation period? (Also see paragraph 39 below re impairment of goodwill.)

Should SMEs be prohibited from capitalising any internally generated intangible assets (eg development costs)? Or should the capitalisation model be required (as in IAS 38)?

What should the IFRS for SMEs require regarding periodic reviews of amortisation periods and amortisation methods? Less frequent than annual? Reassess only if there is a clear indication of change?

39. **Goodwill (Section 18) and intangibles (Section 17) amortisation [AP1.64].** 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.

FT [AP2.77(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.

Staff comment: Allowing or requiring amortisation of goodwill and other indefinite-life intangibles was proposed in many of the comment letters and by some of the field test participants. Here is the Board's reasoning (from Basis for Conclusions) for not having an amortisation approach:

Goodwill impairment

BC79 In their responses to the recognition and measurement questionnaire and at the round-table meetings, many preparers and auditors of SMEs' financial statements said that the requirement in IFRS 3 Business Combinations for an annual calculation of the recoverable amount of goodwill is onerous for SMEs because of the expertise and cost involved. They proposed, as an alternative, that SMEs should be required to calculate the recoverable amount of goodwill only if impairment is indicated. They proposed, further, that the IFRS for SMEs should include a list of indicators of impairment of goodwill as guidance for SMEs. The Board agreed with those proposals. The draft IFRS for SMEs proposes an indicator approach and includes a list of indicators based on both internal and external sources of information.

BC80 Some respondents to the questionnaire and some of those who took part in the round-table discussions proposed requiring amortisation of goodwill over a specified maximum period. Proposals generally ranged from 10 to 20 years. They argued that amortisation is simpler than an impairment approach, even an impairment approach that is triggered by indicators. The Board did not agree with this proposal for three main reasons:

(a) An amortisation approach still requires assessment of impairment, so it is actually a more complex approach than an indicator-triggered assessment of impairment.

(b) Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset over its useful life. By its nature, goodwill often has an indefinite life. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not faithfully represent economic reality.

(c) When the IASB was developing IFRS 3, and related amendments to IAS 38 Intangible Assets, most users of financial statements said they found little, if any, information content in the amortisation of goodwill over an arbitrary period of years.

Should SMEs be required or permitted to amortise goodwill and other indefinite-life intangibles? [See also the first question in the preceding paragraph.]

40. **Business combinations (Section 18) [AP1.65]**. 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).

FT [AP2.76(b)]

- It was difficult to identify 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.

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.

FT [AP2.76(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.

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'.

FT [AP2.77(b)] – Section 18 is too complex

- 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.

In a business combination, should SMEs be exempted from separating all or certain intangibles (such as those with no quoted market price, those that are not legal rights, and/or those that were not recognised by acquiree)?

Should SMEs be exempted from recognising contingent liabilities?

Should the requirements for initial accounting for a business combination be simplified, for instance by prospective rather than retrospective adjustments, or a longer period for determination?

Should SMEs be permitted or required to use merger accounting (pooling of interests method) and, if so, in what circumstances?

41. **Leases (Section 19) [AP1.66].**

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.

FT [AP2.78] - 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.

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.

FT [AP2.79] – Classification problems

- 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.

f. Additional field test issue:

FT [AP2.82(c)] – Allow certain leasehold land to be capitalised

- Some field test 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."

Staff comment: This appears to be the same issue that led to the revision of IAS 40 and may indicate some support for keeping the option to classify property held under an operating lease as investment property, although it's not clear from the field test entities' responses whether the land would meet the requirements to be classified as investment property.

FT [AP2.82] – Section 19 is beneficial but costly

- Some field test entities noted that the requirements in Section 19 would lead to medium to high benefits for users, but some areas were costly to apply.

For operating leases, should the straight-line method be required (spreading total lease payments evenly over the lease term)?

Should the requirement for a finance lease to be measured only at fair value of leased property be changed? If so:

a. should the lower of FV and present value of minimum lease payments be reinstated?

b. or should measurement be at the present value of minimum lease payments?

Should SMEs be exempted from separating land and buildings (or perhaps have an undue cost or effort exemption)?

Should SMEs treat all leases as operating leases?

Do WG members have suggestions for simplifying the lease classification criteria for SMEs, for example, use fewer criteria or use quantitative tests?

Should SMEs be able to capitalise leasehold land in any circumstances? If yes, specify which circumstances.

42. **Provisions (Section 20) [AP1.67].** Simplify measurement requirements, for example, simplify probability estimates and discounting (such as by using the average company borrowing rate).

FT [AP2.83]

- Only a small number of field test 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.

Should SMEs measure provisions by discounting using the entity's average borrowing rate?

Do WG members have other suggestions for simplifying measurement of provisions for SMEs?

43. **Debt - equity classification (Section 21) [AP1.68].** 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.

FT [AP2.84] - 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.

Do WG members believe that the recent IAS 32 changes resolve the SME concerns on this issue? Does this work for co-operatives and partnerships?

Should SMEs be required to perform "split accounting" for compound instruments? Do WG members have any suggestions for simplifications?

44. **Revenue (Section 22) – Additional issues raised in field testing only**

FT [AP2.85] – Problems using percentage of completion method

- 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 (see guidance section below beginning at paragraph 58).

Should SMEs have any relief from applying the percentage of completion method?

Do WG members have any suggestions for simplifying revenue recognition for SMEs?

45. **Government grants (Section 23) – Additional issues raised in field testing only**

FT [AP2.86] – Problems measuring grants at fair value and allocating grants to the components of an asset

- Measuring grants at fair value causes problems due to lack of easily available indicators of the value of the asset or other benefit received.
- Difficult to allocate a government grant to the components of an asset.
- 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.

Staff comment: Here are the requirements of 23.3 to 23.5 in the ED (IFRS for SMEs model for government grants):

23.3 An entity shall account for its government grants using either:

(a) the IFRS for SMEs model in paragraph 23.4 for all government grants; or

(b) the IFRS for SMEs model in paragraph 23.4 for those government grants related to assets measured at fair value through profit or loss and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* for all other grants

23.4 An entity shall recognise government grants as follows:

(a) a grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable;

(b) a grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met;

(c) grants received before the income recognition criteria are satisfied are recognised as a liability.

23.5 An entity shall measure grants at the fair value of the asset received or receivable.

Do WG members support the requirement to follow the IFRS for SMEs model as set out in ED 23.3 and 23.4 (Note the IFRS for SMEs model is only specifically required for items which are measured at fair value so should not impose a further fair value burden)?

Do WG members feel there should be any simplifications for recognition of government grants for SMEs, for example don't require allocation to components of an asset?

46.**Borrowing costs (Section 24) – Question 5 of Invitation to Comment [AP1.69].** 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).

FT [AP2.87]

- 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.

Should immediate expensing be prohibited for SMEs (as it is under IAS 23 as revised)? Or should the capitalisation model be prohibited for SMEs?

Should the IFRS for SMEs allow capitalisation at the average borrowing rate (without tracing specific borrowings)?

47. **Share-based payment (Section 25) [AP1.70].** 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.

FT [AP2.88]

- 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.

Staff comment: Those respondents who said that the intrinsic value method is not much of a simplification pointed out that this method requires knowing the fair value of the underlying equity share when the share option (or other SBP) is granted and at each subsequent reporting date. Staff agrees that this is true, but in most jurisdictions the employee must recognise compensation – and the employer usually gets a tax deduction – for differences between fair value and strike price. Therefore the entity is already measuring fair value for tax purposes.

What are the WG members' views on the intrinsic value simplification for SMEs that already exists in IFRS 2? What further simplifications do WG members propose?

48. **Impairment (Section 26) [AP1.71]:**

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.

FT [AP2.90] - 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.

Should impairment be measured by comparing carrying amount to the greater of net selling price and present value of future cash flows (value in use)? Or should impairment be measured based on the future use of the asset (ie sale or use)? (See paragraph 48(b) below.)

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). Staff views this as a similar proposal to (a) above.

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

FT [AP2.89] – Problems with impairment requirements for 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.

Staff comment: The IFRS for SMEs requires an SME to determine whether there is an indicator that goodwill is impaired (ED 26.20-21). If impairment is indicated, then apply the two steps in paragraph ED 26.22:

26.22 If there is an indication that goodwill has been impaired the entity shall follow a two-step process to determine whether to recognise an impairment loss:

Step 1:

(a) allocate the goodwill to the component(s) of the entity that benefit from the goodwill (generally the lowest level within the entity at which the goodwill is monitored for internal management purposes);

(b) measure the fair value of each component in its entirety, including the goodwill;

(c) compare the fair value of the component with the carrying amount of the component;

(d) if the fair value of the component equals or exceeds its carrying amount, neither the component nor the goodwill is impaired; if the fair value of the component is less than its carrying amount, the difference is an impairment loss that shall be recognised in accordance with Step 2.

Step 2:

(a) write down the component's goodwill by the amount of the loss determined in Step 1(d) and recognise an impairment loss in profit or loss;

(b) if the amount of the loss determined in Step 1(d) exceeds the carrying amount of the component's goodwill, the excess shall be recognised as an impairment loss in profit or loss. That excess shall be allocated to the identifiable non-cash assets and liabilities, including contingent liabilities, of the component on the basis of their relative fair values.

What are the WG members' views on the requirements for impairment of goodwill? Please note that even with amortisation, impairment must be considered.

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

Should the IFRS for SMEs provide for a cash-generating-unit approach?

49. **Pensions (Section 27) [AP1.72].** 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.

What should the IFRS for SMEs require or permit regarding recognition of actuarial gains and losses?

b. Allow deferral and amortisation of past service costs.

Should past service costs be deferred and amortised. [Past service costs are increases in pension expense arising from changes to the terms of a pension plan that give employees increased benefits, and therefore immediately increase an entity's pension obligation?]

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.

FT [AP2.92&93(a)] - 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. Another problem raised was the entities were unable to gather enough data to make estimates about demographic and financial variables as required by 27.16 for defined benefit plans.

Should the requirement in the IFRS for SMEs to use a specific actuarial method be removed?

Should the IFRS for SMEs clarify that an annual actuarial valuation is not required and that updating prior valuations can result in reasonable measurements?

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

Should SMEs measure their defined benefit pension obligation 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.

Staff comment: The ED proposes that multiemployer plans be classified as defined contribution or defined benefit based on their terms. However, if sufficient information is not available to use defined benefit accounting, then an SME can use defined contribution accounting, with disclosure.

Should SMEs be permitted to treat all multiemployer plans as defined contribution?

50. **Income taxes (Section 28) [AP1.73].** 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.

FT [AP2.94&95] – Issues with current method

- 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:
- 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.
- Problems measuring temporary differences. Measurements in the field entity’s restated financial statements are ‘rough’ or are not finalised.
- 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
- 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.
- 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.
- 28.18 should note that if an entity considers the timing differences to be insignificant then there is no need to recognise deferred tax.
- 28.18(b) should provide the same exemption for unremitted earnings of local subsidiaries as it does for foreign subsidiaries.

How should SMEs account for income taxes (what overall method should be required):

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

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

- Timing difference method.

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

- Temporary difference method (as in the ED).

Should SMEs be prohibited from recognising any deferred tax assets, or should the time period be limited for assessing whether there will be sufficient future taxable profit for recovery, to avoid ongoing calculations?

Should SMEs have relief from the requirement to attribute the tax consequences of transactions to discontinued operations or equity as this is complex.

Should the exemptions from initial recognition of deferred taxes in IAS 12, that are not included in the IFRS for SMEs, be reinstated as exemptions for SMEs:

a. Initial recognition of goodwill or other assets and liabilities, whether or not acquired in a business combination (see 28.17).

b. Undistributed earnings of domestic subsidiaries, associates, joint ventures, and branches (see 28.18(b))?

51. **Financial Reporting in Hyperinflationary Economies (Section 29) [AP1.74].** 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%.

52. **Foreign currency translation (Section 30) [AP1.75]**.

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

FT [AP2.97(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.

If the law requires an SME's financial statements to be presented in the national currency, should that national currency automatically be treated 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.

Should SMEs have relief from the requirement to recognise a cumulative exchange difference in profit or loss on disposal of the foreign operation? That amount would have been previously been recognised directly in equity (see 30.13).

53. **Segment reporting (Section 31), earnings per share (Section 34), and interim reporting (Section 37) [AP1.76]**. 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.

FT [AP2.98&102&105]

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

Should the IFRS for SMEs allow SMEs to be able to present voluntary segment information, EPS, and interim information without having to apply the relevant full IFRS?

54. **Related parties (Section 33) [AP1.77].** 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 (ED 33.35–36) 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.

FT [AP2.100&101]

- Several field test entities found the related party requirements onerous and feel such disclosures reveal sensitive information and are not appropriate (All issues raised are included in Agenda Paper 4.)

Staff comment: This is essentially a disclosure issue, and is covered comprehensively in Agenda Paper 4. Staff proposes that the WG discuss related parties during discussion of AP4.

55. **Agriculture (Section 35) [AP1.78].** 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.

FT [AP2.103]

- 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.

Should the cost model be a pure accounting policy choice for agricultural SMEs?

FT [AP2.103] – Classify biological assets as inventory during early production

- 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.

Should the IASB consider the suggestion to classify biological assets as inventory during early production? If not, should the reconciliation requirement be removed for biological assets?

56. **Assets held for sale and discontinued operations (Section 36) [AP1.79].**

    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.

FT [AP2.104] Difficulties in applying Section 36

- 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.
- Difficult to identify cash flows connected with discontinued operations and assets held for sale.
- Difficult to determine fair value less costs to sell for held for sale items, for example for certain buildings.
- Difficult to determine when an asset should be classified as held for sale. More guidance is necessary.

Should assets held for sale be dropped from Section 36 and addressed in other sections or treated as an impairment indicator?

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

FT [AP2.104]

- (See comments above under paragraph 56(a) for assets held for sale)

What are the WG members' views on reporting of discontinued operations by SMEs? Delete requirements? Simplify?

57. **First-time adoption of the IFRS for SMEs (Section 38) – Question 10 of Invitation to Comment [AP1.80].** 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.

FT [AP2.106] - 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.

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.

Should 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) be available to SMEs adopting the IFRS for SMEs for the first time?

Should the use of 'impracticable' be relaxed by providing an exemption from restatement at a far lower hurdle than the 'impracticable' exemption in full IFRSs?

Should the requirements for moving to and from full IFRSs be relaxed, for example, allow moving between full IFRSs and the IFRS for SMEs more than once. Or, is this a matter to be left to each jurisdiction to decide?

Adequacy of Guidance

58. 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 "grey letter" 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.

59. Many comment letters recommended that additional worked examples or narrative guidance be provided in a number of areas. Presented below in the unshaded areas of the table 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. Comment letters did not generally indicate whether they thought the additional guidance 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).

FT [AP2.28-29] – General comments relating to guidance

- Other than to use options available by cross-reference, only about 7% of entities specifically noted 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.
- 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.

Staff comment: Presented below is a list of suggestions for guidance/ the problems that indicate a need for guidance from both the comment letters and the field tests. The unshaded areas of the table below contain the recommendations for further guidance from the comment letters. The areas requiring additional guidance identified by field testing are in the shaded areas of the table and these comprise both

- areas where field test entities directly suggested additional guidance should be added; and
- areas where field test entities noted minor problems in applying certain requirements of the ED, highlighting the potential needed for additional guidance.

The main objective at the meeting is to have an overall discussion regarding what kind of additional guidance/worked examples should be provided and whether this should be provided together with the IFRS for SMEs (for example in the Implementation Guidance or through additional appendixes, like those for Section 20 (provisions) and 22 (revenue)) or whether this guidance can be provided in a supplementary fashion such as through the planned IASCF Training Materials. What are WG members' views on this?

The definition of an SME – an entity that does not have public accountability – includes a wide spectrum of sizes of companies. Larger companies are likely to have more complex transactions than smaller entities, and would want guidance on a broader set of issues and guidance in greater detail, than smaller entities. In thinking of about the guidance that could be provided with the IFRS for SMEs, to which size(s) of entities should the guidance be aimed?

Depending on the time available at the meeting the WG members are asked to consider the specific issues in the table below and suggest (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?

The areas from the table which IASB staff would particularly like views on are:

Should there be a scope paragraph at the beginning of each section explaining which transactions will be addressed in the section?

Should any relevant detail from interpretations be included in IFRS for SMEs, for example IFRIC 1, IFRIC 4, IFRIC 8, IFRIC 12, SIC 10, SIC 12, SIC 15, and SIC 29 have been identified by respondents as relevant to SMEs? Or is it enough to refer to this by the hierarchy in Section 10 (10.2-10.4)?

Should illustrative financial statements be provided for other industry sectors, e.g. financial service section and service commercial and manufacturing entities?

General guidance

(Various sections) Include a paragraph on scope at the beginning of each section explaining which transactions will be addressed.	
(Various sections) Add 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.	
(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.	
(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.	
(Implementation guidance) The inclusion of illustrative financial statements for service, commercial, and manufacturing entities would be helpful to SMEs.	
FT (AP2.29) Add illustrative guidance on the format of financial statements for other industry sectors, in particular the financial service sector.	

Section 1 Scope

FT (AP2.31(a)) Interpreting “in the process of filing” in 1.2(a).	

Section 2 Concepts and Pervasive Principles

FT (AP2.34(a)) Substance over form is a new concept that is difficult to understand.	
FT (AP2.34(b)) A definition of benefits, used in 2.11 to discuss the balance between costs and benefits, would be useful.	
FT (AP2.34(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

FT (AP2.35(a)) Unsure what disclosures to provide as company ceased trading in the year.	

FT (AP2.35(c)) Applying the term materiality led to problems, for example relating to dormant subsidiaries.	

Section 4 Balance Sheet

FT (AP2.36) Difficulties in classifying items between current and non-current. 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.	
FT (AP2.37) Unsure of which line items to show on the balance sheet, for example, if a subtotal for financial liabilities is needed or if separate line items are needed for tax liabilities other than income taxes or for amounts due to related parties.	

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

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.	
FT (AP2.42) 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.)	Already noted directly above by comment letters.
FT (AP2.43) Difficult to measure the amount in 6.2 (b), (each item of income and expense that is recognised directly in equity).	

Section 7 Cash Flow Statement

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.	
Add guidance on reporting cash flows when using equity method or proportionate consolidation for investments in associates and joint ventures (IAS 7.37-38).	
Add guidance on reporting cash flows for acquisitions and disposals of subsidiaries/business units (IAS 7.39-42).	
Cash flow statement in implementation guidance should illustrate acquisition or disposal of subsidiaries.	
FT (AP2.46) Problems classifying cash flows, for instance, whether certain bank deposits are investing or financing and whether repayments of advances are operating or financing.	

FT (AP2.46) 7.18, concerning disclosure of non-cash transactions, is hard to understand and an illustration would be helpful.	
FT (AP2.46) 7.13, concerning unrealised gains and losses from changes in foreign currency exchange rates, is too burdensome.	

Section 8 Notes to the Financial Statements

To improve clarity give examples suited to SMEs illustrating information about judgements (paragraph 8.6) and key sources of estimation uncertainty (paragraph 8.7).	
FT (AP2.47) Uncertain as to when should make disclosures about judgements (paragraph 8.6) and key sources of estimation uncertainty (paragraph 8.7).	

Section 9 Consolidated and Separate Financial Statements

Examples on consolidation procedures should be included in the implementation guidance.	
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.	
Add clearer instructions to 9.21 as to how to prepare combined financial statements. 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.	
Add guidance on how potential voting rights affect control assessment (currently the ED only addresses allocation of profits when potential voting rights exist).	
Add guidance on circumstances when special purpose entities exist.	
Add a description of the cost method.	

FT (AP2.49) Areas where guidance and examples would be useful: - Illustrating minority interests in the illustrative financial statements. - How to determine which of their affiliates are subsidiaries and, therefore, need to be consolidated. - Consolidation methods and acquisition and disposal dates.	Partly noted directly above by comment letters

Section 10 Accounting Policies, Estimates and Errors

Add an example to illustrate changes in accounting estimates eg how a change in estimated useful life of a depreciable asset is accounted for.	
FT (AP2.51) 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. Clarification would be helpful.	

Section 11 Financial Assets and Financial Liabilities

Add guidance on accounting for initial transaction costs on acquisition.	
For financial instruments add examples of computation of amortized cost and effective interest rate.	
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.	
Add guidance on determination of hedge effectiveness (currently there is some guidance in the Basis for Conclusions).	
Add guidance on accounting for financial guarantees.	
Purchase and sale contracts for non-financial items, especially commodity contracts, require further guidance.	
Add guidance regarding approach to accounting for embedded derivatives.	

Guidance on accounting for insurance contracts from a policy holder's point of view.	
FT (AP2.54(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 feel it is not apparent that plain receivables and payables are also addressed in Section 11 (the list in paragraph 11.2 notwithstanding) and feel clarification of the transactions addressed in Section 11 is necessary to overcome this problem, for instance by using simpler language and less abstract wording.	
FT (AP2.54(b)) Lack of clarity on whether Section 11 includes statutory obligations, such as tax obligations and government-mandated employee benefits.	
FT (AP2.54(c)) Problems deciding whether certain instruments are within the scope of Section 11, for example provisions for contingent consideration and government grants in the form of repayable advances.	
FT (AP2.55) Difficult to determine which financial instruments can be measured at amortised cost as 11.9 is difficult to understand. 11.9 should be set out more simply and clearly to help understanding. Particular problems classifying interest-free trade receivables / payables and interest-free intercompany loans, as unclear if they meet the requirement to have a fixed rate of return under 11.9(b).	
FT (AP2.56(e)) Appendix B, covering fair value measurement, is difficult to understand and often not relevant. Practical examples are necessary.	
FT (AP2.56(f)) Unclear how to determine whether a market is active or inactive. Further guidance is needed.	
FT (AP2.58) Practical examples of applying the effective interest rate are necessary.	Already noted directly above by comment letters.
FT (AP2.59(a)) Problems understanding and applying the requirements for testing hedge effectiveness. Additional guidance is desirable.	Already noted directly above by comment letters.
FT (AP2.61) 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).	
FT (AP2.62) 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.	

FT (AP2.63) 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.	Partly noted already above by comment letters.

Section 12 Inventories

Explain the retail inventory method (12.15) suggest adding IAS 2.22.	
FT (AP2.64) Problems applying the full cost approach. Difficult to determine how to allocate costs, for example transportation costs and costs not directly attributable to one product. Since application is difficult, more guidance is needed on how to determine which costs to include in inventories.	

Section 15 Investment Property

Include examples on accounting for various costs incurred in relation to investment property and accounting for impairment or losses of such property.	

Section 16 Property, Plant and Equipment

Add guidance on subsequent costs as Section 16 has guidance only on initial costs.	
FT (AP2.72) Certain parts of Section 16, for example application of component depreciation and determination of useful lives, could benefit from additional guidance.	
FT (AP2.72(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.	
FT (AP2.72(b)) There is room for interpretation as to what the term “incremental future benefits” actually means and further guidance is needed.	

Section 17 Intangible Assets other than Goodwill

FT (AP2.74) Clearer guidance is necessary to help distinguish between research and developments costs.	
FT (AP2.75(a)) Difficult to determine whether certain assets are intangible assets, for example upfront payments made to third parties to conduct research.	
FT (AP2.75(b)) Difficult to determine whether intangible assets have a finite or an indefinite life.	

Section 18 Business Combinations and Goodwill

Add simplified version of Illustrative Examples from IFRS 3 for intangibles acquired in business combination that were not previously recognised by acquiree.	
Add an example to illustrate a reverse acquisition. IFRS 3 Illustrative example IE 5.	
Include examples for step acquisitions.	
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.	
Guidance on initial accounting determined provisionally.	
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.	
FT (AP2.76(a)) Difficulties determining how to account for contingent consideration.	
FT (AP2.76(b)) Unless specific intangibles are given as examples within IFRS for SMEs, entities are unlikely to look for such assets.	Already noted directly above by comment letters.
FT (AP2.76(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.	Already noted directly above by comment letters.

Section 19 Leases

Illustrate calculations for finance and operating leases, from perspective of both lessee and lessor.	
Add accounting requirements for operating lease incentives.	
Add guidance on the accounting treatment for contingent rents under operating leases.	
Add guidance on classification of leases of land and buildings and allocation of lease payments between the two elements.	
FT (AP2.79) Problems applying classification criteria, 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 would lead to finance lease classification, in the absence of factors in 19.4. Examples and quantitative thresholds would be beneficial.	

FT (AP2.82(a)) Lack of guidance for lease incentives, a common feature of lease arrangements.	Already noted directly above by comment letters.
FT (AP2.82(b)) Unsure how to account for hire purchase payables (liability recognised under finance lease).	

Section 20 Provisions and Contingencies

Add guidance from IAS 37.80-81 on restructuring provision costs.	
Add examples of contingent assets to expand 20.13.	
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.	
Add guidance on best estimate of amount required to settle obligation (20.8).	
FT (AP2.83) 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)).	

Section 21 Equity

Add guidance on accounting for equity interests in partnerships and co-operatives.	
Add clear guidance on distinguishing between debt and equity. For example, guidance on high/low redeemable preference shares (are they equity or liability).	
FT (AP2.84) Clear guidance on the differentiation between equity and liability is necessary and some suggested the recent changes to IAS 32 for puttables and obligations arising only on liquidation should be integrated into the IFRS for SMEs.	Already noted directly above by comment letters.

Section 22 Revenue

Provide examples for agency relationships (22.4) and to illustrate deferred payments.	
Add guidance on revenue recognition for multiple-element transactions should be provided.	
Add guidance on revenue recognition for construction contracts. Clarify terms “contract revenue” and “contract costs” to reduce diversity in practice.	

FT (AP2.85) Additional examples requested: a. Contracts for services. 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

Add guidance for loans at nil or low interest rates (government grants).	
FT (AP2.86) The description of the options is unclear, in particular for the IFRS for SMEs model.	
FT (AP2.86(b)) Unsure how to measure the liability for grants in the form of repayable advances.	
FT (AP2.86(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 25 Share-based Payment

Add an example to illustrate application of 25.7 re share-based payment (SBP) transactions with cash alternatives.	
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.	
Provide examples on SBP transactions to minimise confusion.	

Section 26 Impairment of Non-financial Assets

Include examples on the two step process for goodwill impairment tests.	
Add examples to illustrate impairment of non-financial assets.	

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.	

Section 27 Employee Benefits

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.	
Add requirements for group defined benefit plans.	
FT (AP2.93(d)) Unclear whether employee benefits should be a provision or an accrued expense.	

Section 28 Income Taxes

Add examples to illustrate deferred tax calculation and preparation of the tax rate reconciliation.	
Add the rest of the examples on tax basis of liabilities from IAS 12.7 and 12.8 (some already in Section 28) to explain why timing differences in 28.7 and 27.8 are temporary differences.	
If the 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).	
Include more examples (like in IAS 12). Section 28 is clearer than IAS 12, but users may not understand the requirements without more examples.	
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."	
FT (AP2.94(c)) Unsure whether deferred tax assets and liabilities can be offset as there is no guidance. Offset is a common issue.	
FT (AP2.94(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.	
FT (AP2.94(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.	Party noted above by comment letters.

Section 30 Foreign Currency Translation

Add examples to illustrate accounting for importing and exporting activities.	
In 30.11, include examples of non-monetary items that could produce a gain or loss that is recognised directly in equity.	
Add paragraph similar to IAS 21.12 to indicate hierarchy for considering indicators of functional currency.	
FT (AP2.97(a)) More guidance on application of the requirements relating to net investment in a foreign operation would be helpful.	

Section 32 Events after the End of the Reporting Period

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.	

Section 33 Related Party Disclosures

Add an explanation of what is meant by the key concept of the 'amount of the [related party] transactions' in 33.8(a).	
FT (AP2.101(a)) Problems applying the definition of a related party, for example determining who is related.	

Section 35 Specialised Industries

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.	

Section 36 Discontinued Operations and Assets Held for Sale

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.	
36.4 covers reclassification of discontinued operations in income statement if item is no longer held for sale, but gives no guidance on remeasuring asset. Add IFRS 5.27.	
Add more guidance for classification and measurement of held for sale items from IFRS 5.16-29.	
FT (AP2. 104(c)) Difficult to determine when an asset should be classified as held for sale. More guidance is necessary.	Already noted directly above by comment letters.

Section 38 Transition to the IFRS for SMEs

38.11(a) and (b) might benefit from an illustrative example with dates (particularly as ‘date of transition’ is not defined anywhere).	
Add illustrative examples for capitalisation of development costs.	
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.	
Clarify use of ‘undue cost or effort’ exemption regarding comparative period deferred tax balances on transition to IFRS for SMEs.	
FT (AP2.106) Unclear how the impracticability exemption should be interpreted, for example whether several items could remain at previous GAAP measurements and / or whether a previous GAAP balance sheet could be used as the opening balance sheet if restatement was considered impracticable.	
FT (AP2.107(a)) Unclear under which line item to disclose the differences resulting from applying different measurement methods.	