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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Project:	**IFRS for Small and Medium-sized Entities**
Meeting:	**SME Working Group, 10-11 April 2008, London**
Paper:	**Summary of Disclosure Issues Raised in Comment Letters and Field Tests (Agenda Paper 4)**

Objective of Discussion at this Working Group Meeting

1. In February 2007, the IASB published an Exposure Draft (ED) of a proposed International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). The IASB received 162 letters of comment on the ED and reports of field tests of the ED by 116 SMEs. Staff has analysed the comment letters and field test reports and has organised the issues raised into the following four agenda papers for the 10-11 April 2008 meeting of the IASB SME Working Group:

   - Agenda Paper 1 - Summary of Issues Raised in Comment Letters Other than Disclosure Issues
   - Agenda Paper 2 - Summary of Issues Raised in the Field Tests
   - Agenda Paper 3 - List of Issues for Working Group Discussion Other than Disclosure Issues (combines the issues in Agenda Papers 1 and 2)
   - Agenda Paper 4 - Disclosure Issues

   A fifth Agenda Paper deals with IASCF Training Materials for the IFRS for SMEs.

2. Agenda Papers 1, 2, and 3, taken together, address all of the issues other than disclosure issues that were raised in the comment letters and field test reports. Agenda Paper 4 (this paper) addresses separately the disclosure issues.

3. A key objective of the discussion at the April 2008 meeting of the WG is to seek the views of WG members on each of the issues in Agenda Papers 1 – 4 and any other views of WG members on the proposed IFRS for SMEs. 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.

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

Adequacy of Disclosures

5. Each section of the draft IFRS for SMEs includes disclosure requirements. Those requirements are summarised in the disclosure checklist that is part of the draft implementation guidance *Illustrative Financial Statements and Disclosure Checklist*. Question 9 in the Invitation to Comment in the ED asked for views on:

   a. whether any of the proposed disclosures should not be required for SMEs, and why; and

   b. whether there are disclosures that are not proposed that the Board should require for SMEs, and why.

6. Many letters of comment encouraged the Board to make further disclosure simplifications or to drop some proposed disclosures entirely. Some field test entities also proposed reductions as a result of problems they encountered. These issues are enumerated in this Agenda Paper in paragraph 9. Unfortunately, respondents were more forthcoming in their suggestions for change than they were in explaining why they would make the change. Many simply cited cost-benefit considerations and the needs of users of SME financial statements as general reasons for their suggestions.

7. A smaller but still significant number of letters of comment proposed additional disclosures. These proposals are enumerated in this agenda paper in paragraph 10.

8. To give members of the WG an overall picture on how the suggestions by the respondents fit in with all the other disclosure requirements, the Appendix to this Agenda Paper presents the same proposals as in paragraph 9 and 10 in their appropriate place within the disclosure checklist (taken from the Implementation Guidance):

   a. Proposals for eliminations/simplifications in paragraph 9 that relate to a specific disclosure requirement in the ED have been included in the right hand column to the disclosure checklist, adjacent to the related proposed disclosure.

   b. All general comments on eliminations/simplifications (from paragraph 9) and proposals for additional disclosures (from paragraph 10) are included in boxes immediately following the section to which they relate, if appropriate, or at the end of the Appendix.

Every item in paragraphs 9 and 10 is included either in the right hand column of the Appendix or in the boxes, and no others have been added. Therefore WG members can choose to review either paragraphs 9 and 10 below, or the Appendix, or both.

Recommendations to Eliminate or Simplify the Disclosures Proposed in the ED

9. Following is a list of proposals to eliminate or simplify the disclosures proposed in the ED. The list includes all proposals that were suggested by more than two comment letters/ field testers. In addition, some of the proposals that appeared in only one or two comment letters/field test reports are included due to their nature or because they were well reasoned by the respondent. The recommendations by respondents are organised by Section in the ED, and the Section number is shown in parentheses immediately before each proposal.

   - (3) Delete 3.4(d) [effect of departure from IFRS for SMEs] and 3.11(b) [nature of the adjustment when it is impracticable to reclassify comparatives] or add impracticability exception.
   - (4) Reduce disclosure in 4.13 [share capital]. 4.13(b) is contradictory to current regulations in Argentina and Costa Rica, which provide for confidentiality of information for ‘anonymous partnerships’. Consider removing 4.13(iv) as IFRS for SMEs is for entities without public accountability.
   - (5) Revise or delete 5.7, a rather specific list [of components of income and expense that must be separately disclosed]. Also, 5.7(a) (b) (c) (f) and (h) are repeated by 26.25, 12.21, 20.14, 36.2, 20.14 respectively.
   - (5) Delete 5.10 [disclose expenses by nature if shown by function on face of income statement] as it requires additional information to be compiled, which does not represent a simplified application.
   - (8) Delete disclosure of judgements (8.6) and estimation uncertainty (8.7). Or modify, for example, by adding an impracticability exemption.
   - (8) Delete or modify 8.8 [information about externally imposed capital requirements]. In 8.8, it is sufficient to only disclose existence of externally imposed capital requirements and if entity sees any risk of non-compliance or there have been any violations.
   - (10) Delete 10.16-10.17 [disclosure of a change in estimate].
   - (10) For 10.23(d) [disclosure of prior period errors] do not require explanation if impracticable.
   - (11) Delete or modify 11.41. 11.41 requires carrying amounts of financial assets and liabilities to be broken down by “significant types”. This additional disaggregation has little informational value, but is very costly to produce.
   - (11) Delete 11.44 [disclosure of assets transferred but not derecognised].

- (11) SMEs should be able to give less detail under 11.46 and 11.47 [defaults and breaches on loans payable]. For example, in 11.46(a) only disclose the fact (default) and carrying amount of loans payable. If the default was remedied, no disclosures under 11.46 and 11.47 should be required.
- (11) Delete 11.50 and 11.51 [disclosures for hedge accounting]. 11.51 requires general disclosures regarding interest rate risk, foreign exchange risk and default risk for financial assets. Since we view the target user group of SMEs to be more on the creditor side, disclosures regarding financial liabilities and liquidity risks are appropriate. However, disclosures of interest rate risk, foreign exchange risk and default risk for financial assets are less relevant in assessing short term cash flows, liquidity, and solvency.
- (11) Delete 11.52 [risks relating to financial instruments at amortised cost] or add impracticability exemption. 11.52 is complex and expensive for SMEs.
- (11) A principles-based approach to disclosing financial instruments would be simpler than the checklist-based approach in IFRS 7 [much of which is retained in paragraphs 11.40 to 11.52] and would give SMEs greater discretion to determine the level of disclosures appropriate to reflect the nature and extent of their exposure to financial risk and the way they manage that exposure.
- (12) Delete 12.21(d) and (e) [impairment and reversal of impairment of inventory] or add impracticability exemption. In 12.21(e), it would be sufficient to include material amounts of reversals, or delete requirement to describe the circumstances that led to the reversal as it is burdensome and not justifiable for cost-benefit reasons.
- (130 Simplify or delete 13.7(c) [requires disclosure of summarised financial information of associates]. This information is not required for joint ventures. It is difficult to obtain on a timely basis. Related party disclosures are sufficient. Rarely used by users of SME's financial statements.
- (16) Delete property plant and equipment reconciliation (16.29(e)). See general comment on reconciliations below.
- (17) Delete intangible asset reconciliation (17.32(e)). See general comment on reconciliations below.
- (17) Delete 17.33 [additional information on intangibles], in particular 17.33(c) [intangibles acquired by way of a government grant] which is unnecessary on top of 23.5.
- (18) Delete 18.23 [business combinations during the period], except for 18.23(a), (b) and possibly (c), as sensitive and burdensome for SMEs. 18.23(h) and (i) are most problematic. Due to fewer such transactions by SMEs, disclosures are less aggregated so the degree of detail is relatively higher. Information is unlikely to be relevant for users. Regarding first sentence of 18.23(d), SMEs often do not use due diligences and cannot allocate the components of the costs. [Staff comment: what 18.23(d) proposes is disclosure of total cost and how much of that was paid in cash, debt, equity instruments, etc.] If keep 18.23(i), consider only requiring a general description of how the acquiree contributed to profit or loss since acquisition.

- (18) Revise or delete 18.24 [business combinations after the end of the reporting period]. 18.24 should only require the fact that such a business combination was carried out. The detail is too cumbersome. SMEs should not be required to disclose such information for each business combination after the end of the reporting period, but, if applicable, on all business combinations combined.
- (19) 19.12(b), 19.14(a) and 19.23(a) require disclosure of minimum lease payments for leases for each future year. This is more onerous than full IFRSs. Distinguishing between minimum lease payments within 12 months and later than 12 months is sufficient for SMEs. Alternatively, use a breakdown of future minimum lease payments by 'less than one year' and 'more than 5 years' like IAS 17.
- (19) Revise or delete 19.12(c), (d) and (e), [finance leases lessees: minimum subleases, contingent rentals; terms of leases], 19.14(c) and (d) [operating leases lessees: lease payments and description of leases], 19.23(b) and (c) [lessor operating leases: contingent rent and description of leases]. They may involve long explanations as SME may have a small number of high volume contracts with different conditions.
- (19) Provide disclosure relief for lessors applying IAS 17 by cross-reference (19.15). Staff comment: This is a much broader issue than just leases and is identified as a 'general' disclosure comment below. Currently, when an SME elects or is required to look to a full IFRS, it is required also to make the disclosures required in that full IFRS.
- (20) Delete 20.14(e) [change in provision resulting from passage of time and change in rate] (f), (g) [description of obligation and uncertainties], and (h) [expected reimbursement].
- (20) Delete 20.15 (b) and (c) [disclosures relating to contingent liabilities].
- (20) 20.16 [contingent assets] should not be disclosed as a user would make decisions based on unrealised gains.
- (22) 22.28(b) and (c) [amount of each category of revenue] should refer to "significant" categories of revenue to decrease the disclosure burden. Alternatively delete 22.28(c) [amount of revenue from exchanges of goods/services in each category of revenue].
- (22) Substantial information has to be presented in 22.29 – 31 for revenue from construction contracts. As a result, the project process, overall order conditions and complete cost structure is apparent. This is unwelcome and anti-competitive for SMEs. Delete 22.30 [details of construction contracts in progress].
- (25) Delete 25.8 [description of share-based payment arrangements] or consider limiting to arrangements that exist at the end of the period for cost-benefits. In the later case, if there are short-term arrangements (that begin and end in period), this should be reported.
- (27) Delete 27.37 [disclosures about defined contribution plans] as exceeds full IFRS disclosure requirements.

- (27) Reduce disclosures regarding defined benefit plans (27.28). Only need 27.38 (a), (c) and (k). 27.38(f) and 27.38(g) exceed requirements of IAS 19 and are not necessary. Disclosure of the entity's accounting policy for actuarial gains and losses is redundant, as no option is allowed (27.38(b) and 27.39).

- (27) Delete 27.40 - 41 [disclosures for each category of termination benefits] as more onerous than full IFRSs.

- (28) Delete 28.29(b)-(f) [deferred tax] except aggregated amount, as too burdensome. The reconciliation in 28.29 (b) is burdensome, cost intensive, and does not significantly add to the forward looking analysis of the future tax burden. Alternatively allow an "explanatory reconciliation", instead of a numerical reconciliation. Permit SMEs to explain relationship between tax expense (income) and accounting profit in 28.29(b) using gross amounts of the relevant items of income or expense, rather than their related tax effects. Users of SME financial statements often understand the reconciliation when gross amounts, rather than their related tax effects, are used.

- (30) Delete 30.29 [convenience translations].

- (32) 32.9 requires disclosure for each category of non-adjusting events after the end of the reporting period. IAS 10.21 requires the same disclosure but only for 'material' categories of non-adjusting events. As a result, the ED requires more disclosures.

- (33) Delete 33.4 [disclosure of relationships between parents and subsidiaries].

- (33) Delete or modify 33.5 and 33.6 [disclosure of key management personnel compensation]. Only the lump sum amount needs to be disclosed. If disclosure of key management personnel compensation results in providing individual compensation of only 1 or 2 key managers, this information should not be required because it can be sensitive for SMEs.

- (33) Reduce or delete related party disclosures (33.7 - 33.10). We question the relevance of related party disclosures in a non-listed environment. Requirements may cause competitive harm. Related party disclosures might reveal sensitive information which can cause indirect or opportunity costs. Also, disclosure requirements in 33.7- 33.10 are difficult to understand. Only need a general description of the nature of related party transactions - it's not necessary to go into further detail. Related party disclosures are lengthy and onerous. Mandating detailed disclosures for such items could be a matter for local legislation instead.

- (35) Delete 35.1(b) (ii) and (iii) [information about fair value of biological assets measured using cost model]. Such a disclosure in 35.1(b) (iii) defeats the purpose of allowing the cost method so should be deleted.

- (36) Disclosure issues for non-current assets held for sale items and discontinued operations are covered in Agenda Papers 1 to 3.

- (Reconciliations) Do not require disclosure of reconciliations of opening and closing balances, eg 16.29(e) [each class of PP&E], 17.32(e) [each class of intangibles], 20.14 [each class of provisions] and 27.38(c)-(e) [defined benefit liability and fair value of plan assets]. Alternatively, only require reconciliations for the current period (from start to end of current year). We question information usefulness of these reconciliations, particularly when there is either no movement or only one movement in the balance for the year. Not very relevant to users.

- (General) Reduce disclosure requirements for options available by cross-references to full IFRSs. SMEs should not be penalised for choosing the more complex treatment. For example, full IFRS 7 disclosures are required in the event SME chooses to apply IAS 39.
- (General) Requirements to disclose all of the assumptions and similar information in connection with valuation of financial instruments, share based payments, pension liabilities and revalued assets should be reconsidered and simplified.
- (General) To the extent that disclosures are included in group financial statements, the subsidiaries of that group, when preparing individual financial statements, should be exempted from providing full disclosures in certain areas, for example share-based payments, cash flow statements, events after the balance sheet date, segment reporting, employee benefits, related parties, investments in associates and financial instruments.
- (General) IFRS for SMEs should state that non-material items do not require disclosure.
- (General) Rather than giving SMEs detailed disclosure requirements, they should instead follow a skeleton outline of necessary requirements for note disclosures. For example, notes to SME financial statements should be limited to:

  a. description of the major accounting policies.

  b. impact of all changes in accounting policies and prior error corrections on opening balance of equity for the current period (plus restatement of the prior period).

  c. details of assets and liabilities by category or origin (excluding: provisions), where relevant (our proposals lead to separate disclosure on the face of the balance sheet of assets carried at revalued amount (easily disposable) from assets carried at cost);

  d. reconciliations between opening and closing balances for assets subject to depreciation and impairment and provisions. These reconciliations should be based on a standard reconciliation;

  e. a specific reconciliation between the opening and closing balance of net pension liabilities;

  f. details of maturity and interest rates for all financial debt (including finance lease related debt and minimum payments for operating leases);

  g. summarised information related to ownerships in associates and joint ventures (interest share, joint control or significant influence, total revenue, net income and equity for each entity);

h. description and main information related to significant transactions and events of the reporting period (business combinations, major impairments, disposals etc.);

i. off balance sheet items such as commitments, pledges and collaterals;

j. contingencies;

k. hedging strategies and related amounts in the balance sheet; and

l. income tax: basic tax and effective tax rates.

Consider adding the following disclosures

10. Many letters of comment proposed additional disclosures, as enumerated below. The list includes all proposals that were suggested by more than two comment letters/ field testers. In addition, some of the proposals that appeared in only one or two comment letters/ field test reports are included due to their nature or because they were well reasoned by the respondent. They are organised by Section in the ED, and the Section number is shown in parentheses immediately before each proposal:

- (8) Requirements of IAS 1.126 should be added
    - Per IAS 1.126 *"An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements*:
        - *the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office)*
        - *a description of the nature of the entity's operations and its principal activities; and*
        - *the name of the parent and the ultimate parent of the group"*.
- (8) To the extent that a SME uses the optional fallback to any of the full IFRSs (by cross-reference), accounting policies must clearly state that fact.
- (9) For combined financial statements, an SME should be required to disclose the reason why combined financial statements are prepared (like 9.19(a)), the basis for determining which entities are included in the combined financial statements and the basis of preparation of the combined financial statements.
- (11) A movement chart of financial assets could be required by 11.41 to assess changes during period (for example, if changes in the balance sheet are due to purchases or fair value gains).
- (15) For entities with investment properties, the removal of the requirement to disclose fair value for investment properties held at cost is a serious omission as it assists users with their resource allocation decisions. It ignores the fact that a key reason for holding investment properties is their capital appreciation.
- (22) Disclose separately amounts in revenue as principal and as agent.
- (26) Accumulated impairment losses (26.11) should be disclosed in the notes since it provides relevant information for statistical purposes.

- (27) Disclose employee figures to allow ratios, eg personnel cost/productivity per employee, to be calculated and to help to analyse employee expenses or defined benefit obligations.
- (27) 27.36 should require specific information to be disclosed on short-term employee benefits (salaries, social security etc) which are the most important employee benefits for SMEs. Some requirements (e.g. breakdown of employee expense) should be given.
- (31/34/37) Clear disclosure of the basis of preparation of any voluntary disclosures is required so readers can make an assessment of its reliability and comparability.
- (33) SMEs are often heavily reliant on one or a few major customers or otherwise have significant economic dependencies. Knowledge of the nature of those dependences is essential for assessing the SME's future cash flows and financial position. The IFRS for SMEs should require disclosure of reliance on major customers and other economic dependencies.
- (General) Where impracticability or undue cost and effort arguments are used this fact should be disclosed.