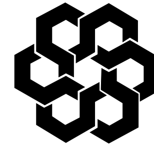

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International Accounting Standards Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**July 2008, London**
Project:	**IFRS for Private Entities (formerly IFRS for SMEs)**
Subject:	**Redeliberation - Issues relating to Sections 13-38 in the Exposure Draft (Agenda Paper 8A)**

1. For the July 2008 Board meeting, the private entity agenda papers are organised as follows:
   - **Agenda Paper 8** – Overview
   - **Agenda Paper 8A** – Issues Relating to Exposure Draft (ED) Sections 13-38
   - **Agenda Paper 8B** – Issues relating to disclosure, including Working Group (WG) recommendations
2. This agenda paper (Agenda Paper 8A) sets out issues relating to Sections 13-38 in the ED of a proposed IFRS for SMEs (to be retitled IFRS for Private Entities). It is based on Agenda Paper 9C for the May 2008 Board meeting. Agenda Paper 9C was updated for the June 2008 Board meeting and retitled Agenda Paper 2B. This agenda paper is an update of Agenda Paper 2B.
3. Agenda Paper 2B (June 2008) included issues and staff recommendations for Sections 11-38. This July paper does not include Sections 11 and 12 as those were discussed at the June meeting. In preparing this agenda paper the staff have amended Agenda Paper 2B (June 2008) where necessary to take into account any impact on the issues relating to Sections 13-38 as a result of Board decisions and discussion at the June 2008 Board meeting.
4. This agenda paper identifies, where applicable any amendments made since the earlier version of this agenda paper was issued as Agenda Paper 9C for the May 2008 meeting. Where this paper has amended an issue or recommendation from

the May and June papers, that is noted in [square brackets] in the title of the issue (see, for instance, the heading for Issue 15.2 immediately above paragraph 22 of this agenda paper). Any additional staff comments and non-substantive wording changes are not highlighted.

5. The issues are numbered sequentially by section number, so the first issue for Section 15 is Issue 15.1, and so on. Questions have the same number as their related issue and may also be labelled with a letter (A, B etc) if there is more than one question for a particular issue.

Sections 13 and 14 Investments in Associates and Joint Ventures

Issue 13.1: Associates and jointly controlled entities – too many options (Issue relates to both Sections 13 and 14)

6. **Comment letters.** The most frequent comment relating to these two sections is that the ED permits too many options in accounting for associates and jointly controlled entities. There were various proposals for reducing or changing the options now in Sections 13 and 14:

   a. Some respondents rejected the 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 and proportionate consolidation methods rather than adding the cost and fair value methods as options.

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

   e. Some would allow a separate policy choice for non-publicly traded investments.

   f. Some letters recommended that the IASB establish a hierarchy for when each method should be used.

   g. Some letters recommended dropping the concepts of investments in associates and joint venture entirely from the IFRS for Private Entities – presumably requiring that such investments be treated as financial instruments under Section 11 *Financial Assets and Financial Liabilities*.

7. **Field tests.** 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 in their view 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 private entities. A few entities agree with allowing different options, but they feel all options should be fully explained in the IFRS for Private Entities rather than cross-referenced to IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.

8. **WG recommendation.** WG members had mixed views on the appropriate method(s) of accounting for associates and jointly controlled entities and, hence, the consensus was that the range of methods proposed in the ED should be retained. Because the ED explains the equity method and proportionate consolidation by cross-reference, elimination of all cross-references will require explanation of these two methods in the IFRS for Private Entities. WG members favoured adding a description of the cost method to the IFRS for Private Entities because this is likely to be the predominantly used method, but it is not described in the ED. WG members would not impose a hierarchy. Nor would they treat all investments in associates and joint ventures as financial instruments under Section 11.

9. **Staff comment:** Items (a) through (g) in paragraph 6 above all relate to the method(s) of accounting for associates and jointly controlled entities that respondents think should be available to private entities. 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 jointly controlled entities. A private entity would be required to adopt a single method for all associates and a single method for all jointly controlled entities.

10. The ED of a proposed IFRS for SMEs was developed before ED 9 on joint ventures (issued September 2007), and commentators may not have taken ED 9 into account. In that project the IASB is considering the appropriate method(s) of accounting for investments in jointly controlled entities and other forms of joint venture. That project is not yet completed.

11. At the May 2008 meeting the staff provided their detailed reasoning for removing the more complex accounting options in the IFRS for Private Entities and, hence, retaining only the simpler options for private entities, where possible (Issue G2 in Agenda Paper 9A for the May meeting). At that meeting, the Board disagreed with the staff recommendation and decided that, in general, the accounting policy options in full IFRSs should be available to private entities (although an exception to this was made at the June 2008 Board meeting for financial instruments).

12. **Staff recommendation.** Staff recommend retaining the cost method and providing a full description of this method as it is expected most private entities will use the cost method and it is an appropriate simplification, without significant loss of information for users. Some private entities may want to choose the equity or proportionate consolidation methods, particularly if they are currently using similar methods under their local GAAP. Staff note that currently both the equity and proportionate consolidation methods are undergoing discussion at full IFRSs level. Staff believe it is premature to start prohibiting any of those methods, requiring some private entities to change their accounting on adoption of the IFRS for Private Entities for the first time and then potentially again at the first update of the IFRS for Private Entities. Any changes should first be made with respect to full IFRSs and then considered in a private entity context. For the above reasons, and consistent with the Board's decision on keeping accounting policy options from full IFRSs available for private entities, staff recommend retaining all of the methods proposed in Sections 13 and 14 of the ED.

Question 13.1

Does the Board agree with the staff recommendation not to amend the ED to restrict the use of any of the methods for accounting for investments in associates and jointly controlled entities?

Issue 13.2: Associates and jointly controlled entities – allow greater time lag between year ends (Issue relates to both Sections 13 and 14)

13. **Comment letters.** Allow private entities a greater time lag than three months for the financial information of associates and jointly controlled entities when applying the equity method or proportionate consolidation, as sometimes it is difficult to obtain timely information. For example, allow information to be for the year ending six months (or even a year) before the investor's reporting date.

14. **Field tests.** No related comments.

15. **WG recommendation.** Not discussed.

16. **Staff comment.** Currently under IAS 28 (since in the ED the equity method is available by cross-reference), when financial statements of an associate used in applying the equity method are prepared as of a reporting date that is different from that of the investor, the difference must be no greater than three months. The same is true for proportionate consolidation under IAS 31.

17. **Staff recommendation.** Staff do not believe that the three-month requirement is a hardship for private entities since both the equity method and proportionate consolidation are optional. Private entities could choose the cost method if it is considered that there will be difficulties obtaining the necessary information on a timely basis. Staff recommend no change to the ED.

Question 13.2

Does the Board agree with the staff recommendation to retain the maximum three month differential for private entities using the equity method or proportionate consolidation, as proposed in the ED via cross-references to IAS 28 and IAS 31?

Section 15 Investment Property

Issue 15.1: Investment property – fair value changes 'through equity'

18. **Comment letters.** Allow the fair value model, but changes in fair value should be recognised in other comprehensive income outside of profit or loss (commentators referred to this approach as 'fair value through equity'). Some letters stated the proposal differently: The IFRS for Private Entities should allow the IAS 16 *Property, Plant and Equipment* revaluation model for investment property.

19. **Field tests.** No related comments.

20. **WG recommendation.** There was no support amongst WG members for a 'fair-value-through-equity' model.

21. **Staff recommendation.** Those who supported 'fair value through equity' expressed some concern about the volatility of profit or loss if fair value changes are recognised in profit or loss. Staff note, however, that the cost-depreciation-

amortisation model is already an option proposed in the ED, and entities using that model could disclose fair values of investment properties in the notes. Staff do not recommend adding a ‘fair value through equity’ option for private entities.

<u>Question 15.1</u>

Do Board members agree with the staff recommendation that the ED should not be amended to give private entities the option to recognise changes in fair value of investment property in other comprehensive income outside of profit or loss?

Issue 15.2: Investment property – do not allow fair value model [Staff recommendation is changed from Agenda Paper 9C May 2008]

22. **Comment letters.** Do not allow the option to use the fair value model for reasons of complexity and lack of comparability.

23. **Field tests.** 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.

24. **WG recommendation.** Members of the WG supported keeping both accounting policy options as proposed in the ED. .

25. **Staff recommendation.** Those who favour allowing a fair value model point out that in many jurisdictions reliable measures of the fair values of investment property are available, and even small private investment property entities manage their investments on a fair value basis. Moreover, fair values are often used as the basis for financing investment properties. Proponents of requiring only a cost model say that this is still a simpler option over obtaining annual fair values. Also, allowing only one option would enhance comparability (though the comparability might be illusory because dates of property acquisition differ from entity to entity and property to property, so cost-based measures are not meaningfully comparable either) and an entity using the cost model can elect to disclose fair values in the notes. Allowing both the cost-depreciation-impairment model and the fair value through profit or loss model as accounting policy options is consistent with the Board’s May 2008 decision that, in general, the accounting policy options in full IFRSs should be available to private entities (although an exception to this was made at the June 2008 Board meeting for financial instruments). Therefore, staff recommend allowing both the cost-depreciation-impairment model and the fair value model.

<u>Question 15.2</u>

Do Board members agree with the staff recommendation that, as proposed in the ED, the IFRS for Private Entities should allow both the cost-depreciation-impairment model and the fair value through profit-or-loss model as accounting policy options for investment property?

Issue 15.3: Investment property – property held under an operating lease

26. **Comment letters.** Remove the option in ED paragraph 15.2 to classify property held under an operating lease as investment property.

27. **Field tests.** Classifying leasehold property as investment property causes problems.

28. **WG recommendation.** WG members supported retaining the option to classify property held under an operating lease as investment property.

29. **Staff comment.** This is an issue only if private entities are allowed an accounting policy option to use the fair-value-through-profit-or-loss model for their investment property. If only the cost-depreciation-impairment model is used, all investment property would be accounted for as property, plant and equipment under Section 16 *Property, Plant and Equipment.*

30. **Staff recommendation.** If the Board agrees with the staff's recommendation in Issue 15.2 to allow both the cost-depreciation-impairment model and the fair value model as accounting policy options, as proposed in the ED, staff recommend retaining the option for a private entity to classify property held under an operating lease as investment property. ED paragraph 15.2 provides an option, not a requirement, and is applied on a lease-by-lease basis. Allowing this option does not impose a burden on private entities. An entity not choosing the option would account for any up-front payment made under such a lease as a prepayment.

<u>Question 15.3</u>

Assuming the Board agrees with the staff recommendation in Issue 15.2, does the Board agree with the staff recommendation to retain the option in ED paragraph 15.2 to classify property held under an operating lease as investment property?

Issue 15.4: Separating mixed-use property

31. **Comment letters.** No related comments. This was an additional issue noted from field testing.

32. **Field tests.** Separating mixed use property between investment property and property plant and equipment is not justified based on cost benefits in certain cases. If an item of property is used both as investment property and operating property, treat it entirely as one or the other depending on its dominant use. Do not require separation of the two components.

33. **WG recommendation.** Not discussed.

34. **Staff comment.** This is an issue only if private entities choose to use the fair-value-through-profit-or-loss model for their investment property. (If only the cost-depreciation-impairment model is used, all investment property would be accounted for as property, plant and equipment under Section 16 *Property, Plant and Equipment*, and separation would not be an issue.)

35. **Staff recommendation.** A private entity owning mixed-use property that feels the separation is burdensome can choose to account for its investment property under Section 16, without having to split out the investment property component. The cost-depreciation-impairment model would have to be chosen as its accounting policy for all investment property, not just mixed-use property. Staff recommend no change to the ED.

Question 15.4

Does the Board agree with the staff recommendation that if a private entity applies the fair value model for investment property, it should be required to separate mixed-use property between investment property and property plant and equipment as proposed in the ED?

Section 16 Property, Plant and Equipment

Issue 16.1: Property, plant and equipment – do not require component depreciation

36. **Comment letters.** Do not require component depreciation for private entities, or make clear that it is optional.

37. **Field tests.** Component depreciation is not relevant and would cause problems if applied strictly.

38. **WG recommendation.** WG members were of mixed views. A majority would retain the component depreciation requirement, as they feel it provides good information and is not unduly burdensome. There was a minority view that felt for cost-benefit reasons this is an area that should be simplified.

39. **Staff comment.** ED paragraph 16.14 states:

    16.14 An entity shall allocate the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciate separately each such part. However, if a significant part of an item of property, plant and equipment has a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item, those parts may be grouped in determining the depreciation charge. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated.

40. **Staff recommendation.** Depreciation is defined as "the systematic allocation of the depreciable amount of an asset over its useful life" (ED glossary). The principle underlying the recognition of depreciation is set out in ED paragraph 16.20: "An entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset's future economic benefits". Component depreciation is consistent with that principle if significant parts of a single asset have significantly different patterns of benefit consumption. At the same time, for most depreciable assets owned by private entities, the entire asset has a common pattern of benefits, and there is no need to split the asset into components. Staff recommend retaining the principle in ED paragraph 16.14 but rewriting 16.14 to make application easier for a private entity by addressing the normal case first, as follows:

    16.14 The entity shall assess whether all of the significant parts of an item of property, plant and equipment have the same useful life and rate of depreciation. If that assessment shows that they all have the same useful life and rate of depreciation, the entity shall recognise and measure the depreciation charge for the asset as a whole. If, however, significant parts of the asset have significantly different useful lives or rates of depreciation

and the entity intends to replace the shorter-lived part(s) while continuing to use the remainder of the asset, the entity shall allocate the initial cost of an item of property, plant and equipment to its significant parts and depreciate each part separately. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated.

Question 16.1

Does the Board agree with the staff recommendation for a rewrite of ED paragraph 16.14 while retaining the principle of component depreciation?

Issue 16.2: Property, plant and equipment – do not require annual review of residual value, useful life, and depreciation method

41. **Comment letters.** Do not require annual review of residual value, useful life, and depreciation method (ED paragraphs 16.17 and 16.21), or reassess only if there is a clear indication of change.

42. **Field tests.** 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 and useful lives should take place at longer periods of time or only if conditions arise that would require such reviews to be performed. Some of the more significant issues noted by field test entities relating to why they were unable to determine residual values, or why they believe annual remeasurement causes undue costs compared to benefits, include:

    a. Residual value can be hard to estimate, and it is questionable whether continual remeasurement has benefits in the financial statements of small private entities.

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

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

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

43. **WG recommendation.** While some WG members found this requirement to be burdensome for a private entity, the majority view was not to make any change to the proposal as private entities would normally be monitoring this type of information as part of good business practice.

44. **Staff recommendation.** Staff note that the annual review of the residual value seemed to be viewed as a bigger burden than the annual review of the useful life or depreciation method. The ED does not prohibit estimating a zero residual value if, in fact, the entity expects the asset to be worthless to the entity at the end of its useful life. However, different private entities might have different policies for maintaining and/or disposing of identical assets. One private entity might do no maintenance on its vehicles because it keeps them only two years before disposal, while another private entity owning the same vehicles may choose to do maintenance and dispose of the asset after a much longer period of benefit.

Therefore, entity-specific estimates of useful life and residual value are essential – with the understanding that, based on some entities' circumstances, residual value could be zero. Because entities' policies for maintenance and/or disposal can change, staff do not support making estimates on the date an asset is acquired and then ignoring those possible changes thereafter. At the same time, the IFRS for Private Entities should be clear that the requirement to review the residual value, useful life and depreciation method does not require the engagement of a valuer or even a complex recalculation at each reporting date. Rather, staff believe it appropriate to reassess those factors only if there is a clear indication of change. Staff recommend that this be clarified in the IFRS for Private Entities with guidance to ensure the requirement is understood and applied correctly.

Question 16.2

Does the Board agree with the staff recommendation that a private entity should reassess residual value, useful life and depreciation method for an asset only if there is a clear indication of change since the last reporting date and, therefore, that ED paragraph 16.17 be clarified accordingly?

Issue 16.3: Revaluation of property, plant and equipment [Staff recommendation is changed from Agenda Paper 9C May 2008]

45. **Comment letters.** Do not allow private entities to revalue PP&E, that is, remove this option. Few private entities will choose this option, and the ED would permit disclosure of fair values of intangible assets, and changes in those fair values, if a private entity chooses to provide these.

46. **Field tests.** 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.

47. **WG recommendation.** WG members would retain this option and other accounting policy options from full IFRSs. .

48. **Staff recommendation.** At the May 2008 meeting, the Board decided that, in general, the accounting policy options in full IFRSs should be available to private entities (although an exception to this was made at the June 2008 Board meeting for financial instruments). Moreover, revaluation of property, plant and equipment has tended to be a common and longstanding practice, even for private entities, in some jurisdictions. Therefore, staff recommends that private entities should not be prohibited from using the revaluation model for their property, plant and equipment.

Question 16.3

Does the Board agree with the staff recommendation that private entities should have the option to use the revaluation model for their property, plant and equipment, as proposed in the ED?

Issue 16.4: Separation of land and buildings

49. **Comment letters.** Add undue cost exemption for separation of land and buildings. This issue also was raised in connection with Section 19 *Leases* and Section 15 *Investment Property*.

50. **Field tests.** No related comments.

51. **WG recommendation.** Not discussed.

52. **Staff recommendation.** Those who support this proposal say separation may require a costly valuation. Staff believe that a private entity that acquires an item of land and building together for a single purchase price will be able to estimate the relative values of the two components. In most jurisdictions the relative values are estimated by tax assessors. Since land is not a depreciable asset, separation would normally be required to compute depreciation for income tax purposes, as well as for product costing purposes. In Issue 38.1, staff recommend adding all of the first time adoption exemptions available in full IFRSs (IFRS 1), and this includes a 'deemed cost' exemption. That exemption could be used to provide relief for any previous purchases of land and buildings on first-time adoption of the IFRS for Private Entities. Staff recommend no change to the ED.

<u>Question 16.4</u>

Does the Board agree with the staff recommendation not to amend the ED by adding an 'undue cost or effort' exemption to Sections 15, 16, and 19 of the ED for the requirement to separate the land and building components when land and building are acquired in a single purchase transaction?

Issue 16.5: Capitalisation of maintenance costs

53. **Comment letters.** No related comments. This was an additional issue noted from field testing.

54. **Field tests.** There is room for interpretation as to what the term 'incremental future benefits' in ED paragraph 16.3 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 did not think incremental benefits are generated.

55. **WG recommendation.** Not discussed.

56. **Staff recommendation.** Staff believe that this matter should be addressed by additional guidance rather than by changing ED paragraph 16.3.

<u>Question 16.5</u>

Does the Board agree with the staff recommendation that the principle in ED paragraph 16.3 (capitalise maintenance cost when there is incremental future benefit) should be retained, but additional guidance should be provided?

Section 17 Intangible Assets other than Goodwill

Issue 17.1: Intangible assets other than goodwill – no 'indefinite life' and, hence, amortise all intangibles [Question 17.1B and related staff recommendation were not in Agenda Paper 9C May 2008]

57. **Comment letters.** Private entities should not be required to distinguish between intangible assets with finite and indefinite useful lives. All intangible assets (including goodwill) should be amortised over the period of benefit subject to a maximum period.

58. **Field tests.** 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.

59. **WG recommendation.** WG members unanimously supported requiring amortisation of all intangibles, subject to an impairment test. This would remove the need to distinguish between intangible assets with finite and indefinite useful lives.

60. **Staff recommendation.** Staff recommend that all intangible assets of private entities should be considered to have a finite life and, therefore, should be amortised over their estimated useful lives. Staff make this recommendation here for intangibles other than goodwill and make a similar recommendation in Section 18 for goodwill. Staff recommend a maximum amortisation period of 10 years should be specified, as private entities are unlikely to be able to estimate accurately the length of a longer finite life. Staff note that the proposed amortisation requirement would not eliminate the requirement, proposed in the ED, to assess at each reporting date whether there is an indication that an intangible asset may be impaired (indicator approach under Section 26 *Impairment of Non-financial Assets*).

61. Staff make this recommendation for several reasons. Firstly, private entities are unlikely to have intangibles other than goodwill with indefinite lives. Secondly, the amortisation approach would still require impairment testing, which staff recommend should continue to be based on an indicator approach as proposed in the ED. Thirdly, from a practical standpoint many smaller private entities would find it difficult to assess impairment as accurately and on such a timely basis as larger/listed entities, meaning the information could be less reliable. Staff support amortisation as an appropriate simplification for private entities as it reduces the likelihood of impairment testing over time. Staff believe that impairment testing is a burden for private entities. Staff's recommendation for amortisation – particularly if coupled with a relatively short maximum amortisation period when useful life cannot be assessed – would reduce the circumstances in which an impairment test would be triggered.

Question 17.1A

Does the Board agree with the staff recommendation that Section 17 should be amended so that, for private entities, all intangible assets other than goodwill are considered to have a finite life and, therefore, should be amortised over their estimated useful lives?

Question 17.1B

If the Board agrees with the staff recommendation in Question 17.1A, does the Board also agree that a maximum amortisation period of 10 years should be specified?

Issue 17.2: Capitalisation of development costs [Staff recommendation is changed from Agenda Paper 9C May 2008]

62. **Comment letters.** Some comment letters said capitalisation of development costs should not be allowed. Others said the capitalisation model should be required.

63. **Field tests.** 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 need to make reference to IAS 38 *Intangible Assets* in order to use the capitalisation model is problematic.

64. **WG recommendation.** WG members supported the proposal to give private entities the option (which is not in full IFRSs) to expense all development costs for simplicity.

65. **Staff recommendation.** Staff recommend that private entities should have the option to expense all development costs. Staff make this recommendation because many private entities do not have the resources to assess commercial viability on a timely and ongoing basis, and users of private entity financial statements do not generally rely on the capitalised amount in their decisions. The capitalised amount provides little if any information about future cash flows – a key concern to users of private entity financial statements. At the May 2008 meeting, the Board decided that, in general, the accounting policy options in full IFRSs should be available to private entities (although an exception to this was made at the June 2008 Board meeting for financial instruments). Given this decision, staff recommends that private entities should not be prohibited from using the capitalisation model for development costs. Therefore, staff recommend that private entities should be provided with both options as proposed in Section 17.

Question 17.2

Does the Board agree with the staff recommendation that, as proposed in the ED, private entities should be able to choose either to expense all development costs or capitalise that portion of development costs that is incurred after commercial viability has been assessed?

Issue 17.3: Intangible assets – annual review of amortisation period and method

66. **Comment letters.** Do not require an annual review of amortisation period and amortisation method (ED paragraph 17.28), or reassess only if there is a clear indication of change.

67. **Field tests.** 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.

68. **WG recommendation.** WG members favoured retaining the requirement as proposed in the ED.

69. **Staff recommendation.** For the same reasons as set out in Issue 16.2, staff propose rewriting this requirement in a manner similar to that proposed for PP&E in Issue 16.2 to clarify it is only appropriate to reassess amortisation period and amortisation method if there is a clear indication of change.

<u>Question 17.3</u>

Does the Board agree with the staff recommendation that a private entity should reassess useful life and residual value only if there is a clear indication of change since the last reporting date and, therefore, that ED paragraph 17.28 be amended accordingly to clarify this?

Issue 17.4: Prohibit revaluation of all intangibles [Staff recommendation is changed from Agenda Paper 9C May 2008]

70. **Comment letters.** Do not allow private entities to revalue any intangibles, that is, remove the option. Few private entities will have intangible assets eligible for revaluation and, of those private entities that do, few will choose the revaluation option. Further the ED would permit disclosure of fair values of intangible assets, and changes in those fair values, if a private entity chooses to provide these.

71. **Field tests.** None of the field test entities appeared to use the revaluation model for intangibles, 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.

72. **WG recommendation.** WG members would retain this option and other accounting policy options from full IFRSs.

73. **Staff recommendation.** At the May 2008 meeting, the Board decided that, in general, the accounting policy options in full IFRSs should be available to private entities (although an exception to this was made at the June 2008 Board meeting for financial instruments). Given this decision, staff recommends that private entities should not be prohibited from using the revaluation model for their qualifying intangible assets.

<u>Question 17.4</u>

Does the Board agree with the staff recommendation to allow private entities to use the revaluation model for their intangible assets as is proposed in the ED?

Section 18 Business Combinations and Goodwill

Issue 18.1: Amortisation of goodwill [Question 18.1B was not in Agenda Paper 9C May 2008]

74. **Comment letters.** 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. (The proposal to amortise all intangible assets is dealt with in Issue 17.1).

75. **Field tests.** Not allowing amortisation of 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.

76. **WG recommendation.** WG members unanimously supported requiring amortisation of goodwill over its estimated useful life, subject to an impairment test using the indicator approach proposed in the ED. Many WG members would impose a maximum life of not more than ten years, with some favouring five years. Most WG members acknowledged that the impairment indicator approach proposed in the ED is consistent with the view that there is generally no foreseeable period over which an entity expects to consume the economic benefits embodied in goodwill, and they also acknowledge that the amortisation approach still requires impairment testing. However, many WG members supported amortisation as an appropriate simplification for private entities as it reduces the likelihood of impairment testing over time. WG members also noted that amortisation can be justified on the basis that purchased goodwill is eventually replaced over time with internally generated goodwill that is not separately recognised. WG members were concerned that impairment testing is a burden for private entities and therefore want to see the circumstances in which it can be triggered substantially reduced. An annual impairment calculation for goodwill was rejected as too onerous for private entities.

77. **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 the Basis for Conclusions in the ED) 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.

78. **Staff recommendation.** Based on the reasons explained in Issue 17.1 and provided by WG members in paragraph 76 above, staff recommend that goodwill (and all other intangible assets) of private entities be considered to have a finite life and, therefore, should be amortised over their estimated useful lives. Staff recommend a maximum amortisation period of 10 years should be specified as private entities are unlikely to be able to estimate accurately the length of a longer finite life. Staff's recommendation for amortisation – particularly if coupled with a relatively short maximum amortisation period when useful life cannot be assessed – would reduce the circumstances in which an impairment calculation would be triggered. Also, from a practical standpoint many smaller private entities would find it difficult to assess impairment as accurately and on such a timely basis as larger/listed entities, meaning the information could be less reliable. Although users of financial statements said they found little, if any, information content in the amortisation of goodwill over an arbitrary period of years, users of private entity financial statements also said they found little, if any, information content in goodwill at all; for example, lenders will not lend against goodwill as an asset. Staff note that the proposed amortisation requirement would not eliminate the requirement, proposed in the ED, to assess at each reporting date whether there is an indication that goodwill may be impaired (indicator approach under Section 26).

Question 18.1A

Does the Board agree with the staff recommendation that Section 18 should be amended to require that goodwill of private entities is considered to have a finite life and, therefore, should be amortised over its estimated useful life?

Question 18.1B

If the Board agrees with the staff recommendation in Question 18.1A, does the Board also agree that a maximum amortisation period of 10 years should be specified?

Issue 18.2: Business combinations – separation of intangibles and allocation of cost

79. **Comment letters.** Simplify allocation of cost. In particular do not require separation of 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 the acquiree).

80. **Field tests.** 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 Private Entities, entities are unlikely to look for such assets.

81. **WG recommendation.** WG members would continue to require separation of intangibles as proposed in ED paragraphs 17.6 and 18.14(c).

82. **Staff recommendation.** ED paragraph 18.14(c) requires separation of intangible assets acquired in a business combination only if their fair value can be measured reliably. Staff believe such intangible assets will normally be estimated as part of the negotiating process and, hence, identification would likely have been part of the negotiation for the business combination. Staff believe that this is not unduly burdensome for a private entity if coupled with a 'without undue cost or effort' condition for the fair value measurement requirement (with guidance to ensure such a condition is used appropriately). In particular, private entities are not likely to enter into many business combinations so this is effectively a 'one-off' requirement. Apart from the addition of an 'undue cost or effort exemption', staff does not propose any changes to the ED.

Question 18.2

Does the Board agree with the staff recommendation that the ED should be amended to state that intangibles acquired by a private entity in a business combination should be separately recognised if their fair value can be measured reliably without undue cost or effort?

Issue 18.3: Business combinations – recognition of contingent liabilities

83. **Comment letters.** Do not require recognition of contingent liabilities.

84. **Field tests.** No related comments.

85. **WG recommendation.** WG members supported the proposal in the ED to require recognition of contingent liabilities acquired in a business combination.

86. **Staff recommendation.** ED paragraph 18.14(c) requires separation of contingent liabilities assumed in a business combination only if their fair value can be measured reliably. Staff believe such contingent liabilities will normally be estimated as part of the negotiating process and, hence, identification would likely have been considered by the parties to the business combination. Staff believe that this is not unduly burdensome for a private entity if coupled with a 'without undue cost or effort' condition to the fair value measurement requirement. In particular, private entities are not likely to enter into many business combinations so this is effectively a 'one-off' requirement. Apart from the addition of an 'undue cost or effort exemption', staff does not propose any changes to the ED.

Question 18.3

Does the Board agree with the staff recommendation that the ED should be amended to require that contingent liabilities assumed by a private entity in a business combination should be separately recognised if their fair value can be measured reliably without undue cost or effort?

Issue 18.4: Business combinations – adjustments of fair value after acquisition

87. **Comment letters.** The ED is unclear about 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. Simplify the requirements for initial accounting, for instance by prospective rather than retrospective adjustments, and provide a longer period for determination.

88. **Field tests.** No related comments.

89. **WG recommendation.** Not discussed.

90. **Staff recommendation.** Staff note this is really an issue relating to additional guidance and hence recommend including in Section 18 the requirements in IFRS 3(2008) for 'measurement period'. Staff does not propose allowing prospective rather than retrospective adjustments as, with suitable guidance, such adjustments are not likely to be problematic and private entities are not likely to enter into many business combinations so this is effectively a 'one-off' requirement.

Question 18.4

Does the Board agree with the staff recommendation to add to Section 18 the requirements in IFRS 3(2008) for 'measurement period'?

Issue 18.5: Consider pooling of interests method

91. **Comment letters.** 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 respondents felt that the purchase method 'is not appropriate'.

92. **Field tests.** Section 18 *Business Combinations and Goodwill* appears very complex. It would be costly to apply, yet the resulting benefits seem rather limited. Field test entities suggested that this is one area where the IASB should try to give private entities material relief, particularly regarding the disclosure requirements.

93. **WG recommendation.** WG members did not support allowing private entities to follow merger accounting for any business combinations other than combinations of entities under common control.

94. **Staff recommendation.** Staff do not recommend allowing private entities to use pooling of interests or book value accounting for a business combination (other than a combination of entities under common control, which are excluded from Section 18 under ED paragraph 18.4). Private entities are not likely to enter into many business combinations, so applying the purchase method is effectively a

'one-off' requirement that provides useful information both for users and for management. Most of the information needed to apply the purchase method should have been determined in order to evaluate a suitable price for the acquisition. The area of Section 18 causing the most significant problems appears to be disclosure, and staff will deal with this separately in a future Board paper.

Question 18.5

Does the Board agree with the staff recommendation that the ED should not be amended to allow private entities to use pooling of interests accounting for a business combination (other than a combination of entities under common control, which are excluded from Section 18)?

Section 19 Leases

Issue 19.1: Leases – operating, straight-line method

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

96. **Field tests.** No related comments.

97. **WG recommendation.** WG members recommended that the requirement for recognising lease payments under operating leases on a straight-line basis as described in ED paragraph 19.13 be retained.

98. **Staff comment.** ED paragraph 19.13 states:

    19.13 A lessee shall recognise lease payments under operating leases (excluding costs for services such as insurance and maintenance) as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.

99. **Staff recommendation.** Those who favour the straight-line requirement point out that recognising contractual lease payments as expenses when paid or payable is, essentially cash basis accounting. Moreover, those payments can easily be structured in agreeing on the lease provisions. On the other hand, those who disagree with the straight-line requirement say that leases are often structured with increasing payments to compensate the lessor for anticipated increases in costs of owning and maintaining the leased property. This is structuring for a business reason, not to achieve an accounting result. Staff notes that ED paragraph 19.13 provides for a method other than straight-line if "another systematic basis is representative of the time pattern of the user's benefit". However, comment letters said this is not sufficient grounds to support using a basis other than straight-line where increases compensate the lessor for increases in costs because the benefits to the lessee may not change from period to period. Only the lessor's costs change. Staff find this reasoning persuasive. Therefore, staff recommend adding a second 'unless' to ED paragraph 19.13 so that it states:

19.13 A lessee shall recognise lease payments under operating leases (excluding costs for services such as insurance and maintenance) as an expense on a straight-line basis unless either (a) another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis; or (b) the payments to the lessor are structured to compensate for the lessor's expected cost increases.

Question 19.1

Does the Board agree with the staff recommendation to revise ED paragraph 19.13 to include the case where payments to the lessor are structured to compensate for the lessor's expected cost increases?

Issue 19.2: Leases – finance, measurement [Staff recommendation is changed from Agenda Paper 9C May 2008]

100. **Comment letters.** Do not require a finance lease to be measured only at fair value of leased property. Two methods were proposed: either reinstate lower of fair value 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.

101. **Field tests.** 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.

102. **WG recommendation.** WG members would keep a single measurement for the leased asset and related lease obligation based on fair value, but they would not call the measurement 'fair value' because private entities will have difficulty in understanding that term and in applying it consistently. Instead, they recommend that the IFRS for Private Entities describe it as 'the cash price that the lessee would have paid if it had acquired the asset rather than leased it'. WG members agree that there shouldn't be any difference at inception between the values at which the liability and the asset should be recognised.

103. **Staff comment.** At the May 2008 meeting the staff proposed that when a current remeasurement is required, that requirement should clearly describe in simple language what the basis for measurement is rather than use the generic term 'fair value' (Issue G13 of Agenda Paper 9A for the May meeting). The Board asked the staff to present a proposal for each required measurement at a future Board meeting. The Board asked the staff, in developing the proposal, to consult the IASB staff teams working on fair value measurements and the measurement phase of the conceptual framework project.

104. **Staff recommendation.** Staff feel many of the problems surrounding fair value measurement could be reduced by clearer explanations of what is required plus additional guidance examples. As the outcome of the discussion on Issue G13 will have a direct impact on Issue 19.2, staff recommend deferring this issue to a future meeting.

Issue 19.3: Criteria for finance lease, including all leases as operating [Question 9.3A was not in Agenda Paper 9C May 2008]

105. **Comment letters.** Simplify classification criteria, for example, use fewer criteria or introduce quantitative tests. Several letters suggested treating all leases as operating leases.

106. **Field tests.** 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 has a significant impact on their capital. 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. 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.

107. **WG recommendation.** WG members did not support adding quantitative criteria into ED paragraphs 19.4 and 19.5 (for classification of a financing lease). Some WG members felt that treating all leases as operating is an appropriate simplification for private entities. The majority, however, did not feel strongly for or against this proposal.

108. **Staff comment.** Paragraph BC97 of the ED gives the Board's reasoning for not treating all leases as operating:

> BC97 Under IAS 17, a lessee's rights and obligations under a lease are not recognised in the balance sheet if the lease is classified as an operating lease. Although lessees obtain rights and incur obligations under all leases, finance leases create obligations substantially equivalent to those arising when an asset is purchased on credit. Information about such assets and obligations is important for lending and other credit decisions. Lenders consistently say that they do not want 'off balance sheet obligations'.

109. **Staff recommendation.** Staff do not recommend that all leases be accounted for as operating leases for the reasons set out in ED paragraph BC97 above. Staff believe that, with one exception (namely 19.4(b)), the principles in paragraphs 19.4 and 19.5 are clear and appropriate and that quantitative guidelines should not be added. Issues may arise due to lack of experience and, perhaps, expertise when applying these principles for the first time; however, this is a matter to be dealt with when looking at what additional guidance is necessary. The only issue staff feel needs to be addressed is whereas 19.4(d) refers to 'substantially all' of the fair value of the leased asset, 19.4(b) refers to 'the major part of the economic life of the asset'. Staff believes that 'substantially all' is clear, while 'major part' is not. 'Major part' is likely to cause unnecessary implementation problems for a private entity. Staff recommends changing 19.4(b) to 'substantially all of the economic life of the asset'. Staff acknowledges that this change is likely to move in the direction of fewer leases being classified as finance leases – depending on how a private entity might have interpreted 'major part'. Staff believes this change is an appropriate clarification and simplification in a private entity context.

Question 19.3A

Does the Board agree with the staff recommendation not to amend the ED to treat all leases as operating leases?

Question 19.3B

Does the Board agree with the staff recommendation to change ED paragraph 19.4(b) to 'substantially all of the economic life of the asset'?

Issue 19.4: Leases – Leasehold land

110. **Comment letters.** No related comments (other than with regards to leasehold land that is classified as investment property – see Issue 15.3). This was an additional issue noted from field testing.

111. **Field tests.** 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." The result would be to allow private entities to capitalise more leasehold land.

112. **WG recommendation.** WG members felt that the requirements can be left as proposed in the ED.

113. **Staff comment.** Currently Section 15 (and IAS 40) allow a special case where leasehold land can be capitalised if it otherwise meets the definition of investment property and the entity applies the fair value model to all investment property (This is dealt with in Issue 15.3). It's not clear from the field test entities' responses whether the land would meet the requirements to be classified as investment property. This is a substantive issue only if private entities are allowed an accounting policy option to use the fair-value-through-profit-or-loss model for their investment property, which staff has recommended should be allowed as an option for private entities in Issue 15.2. If the cost-depreciation-impairment model is used, all investment property would be accounted for as property, plant and equipment under Section 16 *Property, Plant and Equipment*.

114. **Staff recommendation.** The issue dealt with in Issue 15.3 is a special case consistent with full IFRSs, and staff sees no reason to allow other types of leasehold land to be capitalised. Staff proposes no change to the ED.

Question 19.4

Does the Board agree with the staff recommendation not to change the ED to allow leasehold land to be capitalised without regard to whether the leasehold land otherwise meets the criteria to be accounted for as investment property?

Section 20 Provisions and Contingencies

Issue 20.1: Measurement requirements for provisions

115. **Comment letters.** Simplify measurement requirements for provisions, for example, simplify probability estimates and discounting (such as by using the entity's average borrowing rate).

116. **Field tests.** Only a small number of field test entities noted difficulties with applying paragraphs 20.8 to 20.11 of 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 felt 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 an insurance receivable and use of weighted average expected amounts (20.8(a)). Examples of provisions recognised by the field test entities include provisions for warranty costs and risks in delivering live easily damaged products.

117. **WG recommendation.** WG members did not recommend any simplification of Section 20.

118. **Staff recommendation**. Staff do not recommend any simplification to the measurement requirements for provisions under Section 20 as this was only highlighted as a problem area by a relatively small number of comment letters and field test entities. The issues relating to provisions covered by Section 20 that a typical private entity might encounter include sales refunds, warranties, and contingent liabilities. Most issues raised by respondents relate to the calculations required so could be mitigated by providing more measurement examples, either in the appendix to Section 20, in the IASCF training material or otherwise. The ED includes a specially developed example for calculation of a warranty provision. Other examples of provisions, for example refunds, could easily be added as implementation guidance.

Question 20.1

Does the Board agree with the staff recommendation that the requirements for measuring provisions proposed in Section 20 of the ED do not need to be simplified?

Section 21 Equity

Issue 21.1: Classification of equity/liability – different legal forms of entity

119. **Comment letters.** The current distinction between equity and liability in Section 21 causes problems since it does not consider the different legal forms of entity within the proposed scope of the IFRS for Private Entities. In particular, Section 21 should address the concerns that what is considered as equity by certain entities is classified as liability under the ED. Various suggestions were made by respondents to achieve what they consider to be the appropriate debt-equity classification for certain types of entities, such as cooperatives and partnerships. An equity definition linked to loss absorption (or participation in losses) was the most common suggestion. A few letters also suggested incorporating the recent changes made to IAS 32 regarding classification of puttable instruments and

obligations arising on liquidation (although these were still in exposure draft stage at the time the letters were written).

120. **Field tests.** Several field test entities are partnerships or cooperatives, and most of them noted that, under the ED, they have no equity (because of the rights of partners or members to withdraw their capital), which does not appropriately reflect the fact that the partners and members bear the residual risks and hold the residual interests in the assets of the entity. Several entities said clear guidance on the differentiation between equity and liability is necessary. Some suggested the recent changes to IAS 32 for puttables and obligations arising only on liquidation should be integrated into the IFRS for Private Entities (although these were still in exposure draft stage at the time the field testing was performed).

121. **WG recommendation.** Members of the WG recommended adopting in the IFRS for Private Entities the recent changes made to IAS 32 regarding puttable instruments and obligations arising on liquidation, though they would simplify the wording. Some WG members were unsure if those changes would be sufficient on their own to address the concerns of cooperatives, and they suggested that some research may be appropriate.

122. **Staff comment.** The comment letters on the ED and the reports of the field tests were prepared 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:

    a. Puttable instruments that meet certain criteria, which include being subordinate to all other classes of instruments and entitling 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.

    b. 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.

123. **Staff recommendation. TO BE DEVELOPED.** The comment letters on the ED and the reports of the field tests were prepared before the IASB's final changes to IAS 32 were adopted for puttable instruments and obligations arising on liquidation. Therefore, staff have sent a short questionnaire to the seven cooperative organisations submitting comment letters on the ED, and to several other organisations, to see if those organisations feel that the recent changes to IAS 32 would resolve their concerns about debt/equity classification under ED Section 21 and, if not, what further changes they would propose in this area. Staff will present its recommendation(s) in this regard to the Board at a future Board meeting.

Question 21.1
TO BE DEVELOPED.

Issue 21.2: Classification of equity/liability– compound instruments should be classified as either equity or liability [Staff recommendation added since Agenda Paper 9C May 2008]

124. **Comment letters.** Separating debt and equity components is complex so the requirements for split accounting should be simplified. Some respondents suggested that the IFRS for Private Entities should not require split accounting at all, in other words all compound instruments would be classified in their entirety either as equity or liability by convention. Suggestions made by respondents for how to make such classification by convention include:

    a. Compound instruments should be classified by convention either as wholly equity or wholly debt. Convertible debt should always be classified as debt and debt that must be settled by issuing a fixed number of shares should always be classified as equity. Only the instruments giving rise to the creation or the delivery of a fixed number of shares should be classified as equity as the only debt component in these instruments would result from interest paid at market interest rates.

    b. Account for all compound instruments as liabilities.

    c. Create a separate balance sheet category for all hybrid instruments, but provide adequate disclosure in the notes so users will not have less information and can make their own adjustments to the financial information, if they wish to.

    d. Permit private entities to choose to account for the instrument either as a compound instrument under the requirements of IAS 32 or account for the entire instrument as liability. Allow the choice on an item by item basis due to the potential differences in nature of each financial instrument an entity may issue.

    e. An instrument that contains an obligation (contingent or otherwise) to pay cash or another financial asset should be classified as a liability in its entirety with the exception of an instrument puttable at fair value that represents a residual interest in the entity. An instrument that contains no obligation to pay cash or another financial asset should be classified as equity in its entirety. All convertibles that contain an obligation to pay cash would be classified as liabilities until conversion. Application of the requirement in IAS 39.AG8 would exclude changes in cash flow variability relating to the anticipated exercise of the conversion option but all other variations in estimated future cash flows would be recognised in the income statement as they arise.

125. **Field tests.** 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.

126. **WG recommendation.** Not discussed.

127. **Staff recommendation.** Staff recommend eliminating the requirement for an issuer to apply split accounting for compound instruments. Classifying compound

instruments into their debt and equity parts and measuring such parts is complex and likely to be too sophisticated for many private entities. In particular, for a non-listed entity, it may be difficult to determine what would have been the interest rate if the debt had no embedded equity feature. Also, this 'imputation' is not likely to be understood by users of private entity financial statements. Instead, staff recommend a compound instrument should be presumed to be liability in its entirety unless the entity has an unconditional right to avoid delivering cash or another financial asset, in which case it should be accounted for as equity in its entirety. Staff also recommend appropriate disclosure should be provided to explain the nature of the instrument.

128. Staff recommend that guidance is also added to Section 21 to clarify that in the case where a compound instrument is in substance two different instruments combined together (such as a debt instrument with separable warrants or rights), the two different instruments should be accounted for separately.

<u>Question 21.2</u>

Does the Board agree with the staff recommendation that the ED should be amended to prohibit split accounting by private entities and instead the entire compound instrument should be accounted for as a liability in its entirety unless the entity has an unconditional right to avoid delivering cash or another financial asset, in which case it should be accounted for as equity in its entirety?

Section 22 Revenue

Issue 22.1: Revenue – percentage of completion

129. **Comment letters.** Some comment letters proposed simplifying the percentage of completion method. Some went even further to propose allowing the completed contract method to be used for all construction contracts and revenue from services.

130. **Field tests.** 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 said they would find additional examples useful.

131. **WG recommendation.** WG members did not support using the completed contract method for construction contracts or revenue from services if the outcome can be estimated reliably. Instead, they recommended that Section 22 should be kept broadly as drafted, but that the description of the percentage-of-completion method should be improved to make it more understandable to private entities. They also recommended providing additional examples to illustrate percentage-of-completion calculations and presentation.

132. **Staff recommendation.** Staff recommend that the Board retain the percentage of completion method for construction contracts and revenue from services for the following reasons:

a. In ED paragraph BC99 it is noted why the IASB did not adopt the completed contract method for contracts that take more than one annual reporting period to complete. BC99 notes that:

BC99 The completed contract method can produce a potentially misleading accounting result for a long-term contractor, with some years of large profits and other years of large losses. Many construction contractors are SMEs. The fluctuation between years of large profit and years of large losses may be magnified for SMEs because they tend to have fewer contracts than larger entities. Users of financial statements have told the Board that, for a long-term contractor, the percentage of completion method provides information that they find more useful than the completed contract method.

b. Many comment letters said they agreed with BC99 that the percentage of completion method provides more useful information.

c. Private entities operating in the major sectors where construction contracts are common, such as engineering and building, should have qualified professionals that can perform the necessary measurements in order to apply the percentage of completion method without too much difficulty.

d. Few comment letters proposed simplifications of the percentage of completion method (other than replacing it altogether with the completed contract method), and no proposal came up more than once.

e. Staff feel that most problems respondents have with applying the measurement requirements for the percentage of completion method can be mitigated by providing more examples, in the appendix to Section 22, in the IASCF training material, or otherwise.

Question 22.1

Does the Board agree with the staff recommendation that the percentage of completion method should be retained as proposed in Section 22?

Section 23 Government Grants

Issue 23.1: Government grants measurement and allocation [Staff reasoning modified from that in Agenda Paper 9C May 2008 and Agenda Paper 2B June 2008, but overall recommendation is unchanged]

133. **Comment letters.** Several comment letters suggested that only the 'IFRS for SMEs model' for government grants as described in ED paragraph 23.3(a) should be allowed as it was simpler and produced better information. A similar number of comment letters suggested only the options in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* should be allowed to maintain consistency with full IFRSs and because some felt the 'IFRS for SMEs model' was unclear.

134. **Field tests.** Measuring grants at fair value caused problems for some field test entities due to lack of easily available indicators of the value of the asset or other benefit received. They noted difficulties in allocating 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. 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 the 'IFRS for SME model'..

135. **WG recommendation.** Not discussed.

136. **Staff comment.** Here are the requirements of ED paragraphs 23.3 to 23.5 in the ED (23.4 and 23.5 set out the '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.

137. The recognition of non-monetary grants at fair value is not mandatory under IAS 20. IAS 20 allows, as an alternative treatment, that the grant and the asset be recorded at a nominal amount. Therefore, currently under the ED, if an entity applies ED paragraph 23.3(b), the only time there is a mandatory fair value requirement for a non-monetary grant is when it relates to an asset measured at fair value through profit or loss (and, hence, the 'IFRS for SMEs model' must be applied). Under the ED, this would most likely be limited to grants relating to agricultural assets whose fair value can be measured reliably without undue cost or effort and investment property for which the private entity has adopted the fair value model as its accounting policy.

138. **Staff recommendation.** Staff recommend that the Board remove the option to apply IAS 20 (namely delete ED paragraph 23.3) for the following reasons:

a. At the May 2008 meeting, the Board decided that, in general, the accounting policy options in full IFRSs should be available to private entities (although an exception to this was made at the June 2008 Board meeting for financial instruments). Nonetheless, staff believe that accounting for government grants is a special case since the proposed 'IFRS for SMEs model' – if combined with further explanation and guidance – is a genuine simplification from the complexities of the various alternatives allowed under IAS 20 and would generally provide more relevant information for users than the options under IAS 20.

b. Staff feel the 'IFRS for SMEs model' is easier to understand than the many options in IAS 20. Many of the respondents supporting the IAS 20 requirements over the 'IFRS for SMEs model' do so to maintain consistency with full IFRSs and also because they feel the 'IFRS for SMEs model' is anticipating future changes to full IFRSs. Staff feel simplicity in a private entity context should take precedence over consistency with full IFRSs.

c. In some cases the 'IFRS for SMEs model' may require more fair value measurement than the IAS 20 model. Field testers expressed problems applying the fair value measurement requirement in this section. At the May 2008 meeting the staff proposed that when a current remeasurement is required, that requirement should clearly describe in simple language what the basis for measurement is rather than use the generic term 'fair value' (Issue G13 of Agenda Paper 9A for the May meeting). The Board asked the staff to present a proposal for each required measurement at a future Board meeting. . Staff recommend deferring the debate on how the reference to fair value in the 'IFRS for SMEs model' should be amended to a future meeting when Issue G13 is discussed.

Question 23.1

Does the Board agree with the staff recommendation that the' IFRS for SMEs model' should be the requirement for all government grants in Section 23 and, therefore, that the option to follow IAS 20 for grants not related to assets measured at fair value through profit or loss should be eliminated?

Section 24 Borrowing Costs

Issue 24.1: Borrowing costs – should both methods be retained [Staff recommendation is changed from Agenda Paper 9C May 2008]

139. **Comment letters.** Approximately 75 per cent of the letters responding to the specific question in the Invitation for Comment supported retention of both methods of accounting for borrowing costs – immediate expensing and capitalisation of borrowing costs on construction of qualifying assets. Approximately 15 per cent of the letters supported capitalisation only.

140. **Field tests.** 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.

141. **WG recommendation.** WG members supported giving private entities the option to expense all borrowing costs since expensing is the simpler approach. But they would also allow capitalisation as an accounting policy option.

142. **Staff recommendation.** Due to the Board's decision at the May 2008 meeting that, in general, the accounting policy options in full IFRSs should be available to private entities staff recommend that private entities should have a choice between the expense model and the capitalisation model, as proposed in the ED. Staff feel that adding the expense model, which is not in full IFRSs, is justified in this case as the benefits from applying the capitalisation model are unlikely to exceed the costs of providing the information for many private entities, since the

capitalisation method can be complex and subjective, so may not be applied correctly, particularly by smaller private entities.

Question 24.1

Does the Board agree with the staff recommendation that private entities should have an accounting policy option to apply either the capitalisation model or the expense model for borrowing costs as proposed in the ED?

Issue 24.2: Borrowing costs – simplification of capitalisation model

143. **Comment letters.** 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).

144. **Field tests.** 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.

145. **WG recommendation.** WG members did not support any simplification of the method from that described in IAS 23 *Borrowing Costs*, such as by using the average borrowing rate for all capitalisation.

146. **Staff recommendation.** The staff believes that there is no need to simplify the capitalisation method by allowing the average borrowing rate to be used since the expense model is provided as a simplification if entities find the capitalisation model too complex. Moreover, private entities are likely to have only a few project-specific borrowings, so tracing of borrowing costs to projects should not be burdensome in most cases.

Question 24.2

Does the Board agree with the staff recommendation that the capitalisation model in the ED does not need to be simplified, for example by allowing the average borrowing rate to be used?

Section 25 Share-based Payment

Issue 25.1: Share-based payment (SBP) – more simplification than just intrinsic value for equity-settled share-based payments (including possibly disclosure only) [Question 25.1B has been added since Agenda Paper 9C May 2008, and staff reasoning has been modified since Agenda Paper 2B June 2008]

147. **Comment letters.** Simplify – the intrinsic value method is not much of a simplification as 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. Possible simplifications include intrinsic value measured only at grant date (not updated) or substituting historical volatility of an appropriate industry sector index for expected volatility of a non-publicly accountable entity's share price in an option-pricing model as per SFAS 123(R). Also, consider disclosure only for equity-settled share-based payments.

148. **Field tests.** Few field test entities had SBP transactions. Two had equity-settled SBP transactions, and they commented that they were unable to measure fair values of either the shares or the share options. A few entities that did not have any SBP transactions commented that they would have found Section 25 difficult had they needed to apply it.

149. **WG recommendation.** Most WG members felt that the intrinsic value method in IFRS 2 *Share-based Payment* is not much of a simplification for private entities because it still involves determining the fair value of unquoted instruments and additionally requires this to be done every year. Many WG members who hold this view support a disclosure only approach. If the Board does not agree with the disclosure-only approach, WG members recommend that the Board seek further simplifications beyond the requirements of IFRS 2. WG members noted that a few comment letters provided ideas for simplification including:

   a. determining intrinsic value at grant date only,

   b. using the calculated value method like in the US standard SFAS 123(R), which also requires measurement only at grant date, and

   c. allowing subsidiaries to record a share based payment expense on the basis of a reasonable allocation of the group charge when awards are granted by a parent company to the employees of different subsidiaries in the group.

   Some WG members felt that only determining intrinsic value at grant date would be an improvement on the current requirements. The other two methods above were not discussed.

150. **Staff comment:** The US statement FAS 123(revised 2004) requires non-public entities to account for awards of equity instruments using the fair-value-based method unless it is not possible to reasonably estimate the grant-date fair value of awards of equity share options and similar instruments because it is not practicable to estimate the expected volatility of the entity's share price. In that situation, the entity is required to account for those instruments based on a value calculated by substituting the historical volatility of an appropriate industry sector index for the expected volatility of the entity's share price**.**

151. BC 137 of IFRS 2 states "For an unlisted entity, there is no published share price information. The entity would therefore need to estimate the fair value of its shares (e.g., based on the share price of similar entities that are listed, or on a net assets or earnings basis)." It is not clear whether the FAS 123(2004) method of substituting historical volatility of an appropriate industry sector index for expected volatility would be consistent with what is already required in IFRS 2 (as indicated by BC 137 above and also BC139-140 of IFRS 2 below) providing the entity also determined the fair value of its shares based on that same index. For instance, would an appropriate industry sector index be considered to be an index of similar entities that are listed?

   BC139 An unlisted entity that regularly issues share options or shares to employees (or other parties) might have an internal market for its shares. The volatility of the internal market share prices provides a basis for estimating expected volatility. Alternatively, an entity could use the historical or implied volatility of similar entities that are listed, and for which share price or option price information is available, as the basis for an estimate of expected volatility. This would be appropriate if the entity

has estimated the value of its shares by reference to the share prices of these similar listed entities. If the entity has instead used another methodology to value its shares, the entity could derive an estimate of expected volatility consistent with that methodology. For example, the entity might value its shares on the basis of net asset values or earnings, in which case it could use the expected volatility of those net asset values or earnings as a basis for estimating expected share price volatility.

BC140 The Board acknowledged that these approaches for estimating the expected volatility of an unlisted entity's shares are somewhat subjective. However, the Board thought it likely that, in practice, the application of these approaches would result in underestimates of expected volatility, rather than overestimates, because entities were likely to exercise caution in making such estimates, to ensure that the resulting option values are not overstated. Therefore, estimating expected volatility is likely to produce a more reliable measure of the fair value of share options granted by unlisted entities than an alternative valuation method, such as the minimum value method.

152. **Staff recommendation.** Staff does not recommend a disclosure-only approach for equity-settled SBPs for the reasons given in BC 101 of the ED.

BC101 Non-recognition is inconsistent with the definitions of the elements of financial statements, especially an expense. Moreover, users of financial statements generally hold the view that share-based payments to employees should be recognised as remuneration expense because (a) they are intended as remuneration, (b) they involve giving something of value in exchange for services, and (c) the consumption of the employee services received is an expense.

In addition to raising measurement reliability and complexity concerns, commentators supporting a disclosure-only approach for share options generally argued that there is no cost to the entity. In the staff's view, that argument would lead, illogically, to non-recognition of transactions involving other equity instruments (e.g., shares) and to equity instruments issued to other parties (e.g., suppliers of professional services).

153. Staff feels that, for personnel management, taxation, and other business reasons, entities will generally be aware of the value of the compensation that they are giving to their employees. Staff note that in many jurisdictions the employee must declare compensation and the employer gets a tax deduction for differences between fair value and strike price. In such circumstances, the entity is already measuring fair value for tax purposes.

154. Staff acknowledge that the intrinsic value method does not provide much of a simplification and in some cases could be seen as more burdensome than determining the fair value of equity-settled SBPs, such as employee share options. That is because the intrinsic value (and hence the fair value of the shares) would need to be determined at each reporting date. However, staff does not support a requirement where intrinsic value is only determined at grant date as in many cases this value will simply be zero even though the SBP is intended as compensation and will often be substantial in value when exercised.

155. **PROPOSAL FOR MEASURING EQUITY-SETTLED SBPs STILLTO BE DEVELOPED.** Staff believe that the IFRS 2 approach for measuring equity-settled SBPs, including use of intrinsic value if fair value cannot be measured reliably and the use of industry volatility measures, does not go far enough to provide suitable relief for private entities. Staff is currently discussing ways to carry out further research in this area and will therefore bring this issue back to a future Board meeting.

156. Regarding group arrangements, staff recommend allowing subsidiaries to record a SBP expense on the basis of a reasonable allocation of the group charge when awards are granted by a parent company to the employees of different subsidiaries in the group. Staff feel this would provide an appropriate simplification, without significantly reducing the usefulness of the information provided. Staff believe this treatment should only be permitted when the parent prepares consolidated financial statements in accordance with IFRS for Private Entities or full IFRSs and appropriate disclosure of the basis of allocation is given.

Question 25.1A

PROPOSAL FOR MEASURING EQUITY-SETTLED SBPs STILL TO BE DEVELOPED

Question 25.1B

Does the Board agree with the staff recommendation that the ED should be amended to permit subsidiaries to record a share-based payment expense on the basis of a reasonable allocation of the group charge when awards are granted by a parent company to the employees of different subsidiaries in the group provided suitable disclosure is made and the parent entity presents consolidated financial statements under the IFRS for Private Entities or full IFRSs?

Section 26 Impairment of Non-financial Assets

Issue 26.1: Impairment – value in use measurement [Staff recommendation added since Agenda Paper 9C May 2008]

157. **Comment letters.** Allow or require consideration of value in use or a simplified value in use calculation that uses information easily available to a private entity – for example allow entities to use their own incremental borrowing rate and their own budgets for cash flow forecasts. The ED would require only fair value measurement. Value in use is more realistic because it takes expected future use of an asset into account. Some respondents felt that the impairment test should be carried out on the basis of the scenario 'sale or use' that is relevant to the entity.

158. **Field tests.** Several field test entities noted that value in use should be reintroduced; otherwise, impairment losses will be recognised that are not justified, for example, for computers/vehicles that are being used in the business. Some entities said that the requirement to use fair value to determine impairment causes problems due to the lack of available indicators.

159. **WG recommendation.** WG members recommended reinstating the notion of 'value in use' in the measurement of impairment, since value in use considers the business reality of the future cash flows from the use of assets. Some WG members felt impairment should be measured by comparing carrying amount to

the greater of net selling price and value in use. Comment letters suggested two other ways of reintroducing value in use in the IFRS for Private Entities. One method would be to allow or require value in use instead of fair value less costs to sell. Another method would be to perform an impairment test on the basis of the scenario 'sale or use' that is relevant to the entity. Neither of these two additional methodologies was specifically discussed by the WG.

160. **Staff comment.** ED paragraph 26.11 states the following:

> 26.11 When the fair value less costs to sell of an asset (or a group of assets) is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its fair value less costs to sell. That reduction is an impairment loss.

161. **Staff recommendation.** Staff recommend that the term 'recoverable amount' should be reintroduced, and that it should be defined to be the present value of the probable future cash flows from the use or the sale of the asset or group of assets, whichever is expected to occur. Therefore, recoverable amount will depend on whether the asset is intended to be sold or used within the business. When the recoverable amount of an asset (or a group of assets) is less than its carrying amount, an entity shall reduce the carrying amount of the asset to its recoverable amount. Staff recommend the following guidance is added:

   a. Where the entity intends to sell the asset, but there is no binding sale agreement, recoverable amount would usually be the market price less any expected costs of disposal of the asset or group of assets (discounted if the time value is material). If an active market is not available, it should be stated that the recoverable amount may need to be estimated using a present value calculation which considers the proceeds expected to be received and costs expected to be incurred before sale.

   b. Where the entity does not intend to sell the asset in the near future**,** recoverable amount would be the present value of the future cash flows expected to be derived from use of the asset (or group of assets)**.**

162. Staff were persuaded by the comments made by respondents that a fair-value-only approach to impairment does not always appropriately reflect the reality if there is no intention to sell the asset and could result in excessive write downs of assets, for example the market value of an asset, such as a motor vehicle or computer declines rapidly but the value in use of the asset would still support the carrying amount. In the preceding paragraph, staff have suggested a slightly modified approach to that in IAS 36 *Impairment of Assets.* The staff's proposed approach considers the entity's intention (sale or use) for the asset (group of assets) for the following reasons:

   a. Under this modified approach, if the intention is to use the asset within the business, an entity will not need to determine fair value less costs to sell. Staff acknowledge that in some cases it may be difficult to obtain such fair values, for example if assets are not traded on active markets. Under the IAS 36 approach fair value must still be determined in order to assess the higher of fair value less costs to sell and value in use. However IAS 36.20 does note:

   > IAS 36.20 It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine fair value less costs to sell

because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value in use as its recoverable amount.

The simplification staff have proposed for private entities will not result in overstatement of assets compared to IAS 36 as the asset would never be written down lower than its value in use (due to the 'higher of' requirement in the definition of recoverable amount in IAS 36). Staff propose not making any reference to 'fair value' and instead use terms such as selling price or market value, to assist understanding. Note: this is related to Issue G13 from the May 2008 meeting where the staff proposed that when a current remeasurement is required, that requirement should clearly describe in simple language what the basis for measurement is rather than use the generic term 'fair value'. The Board asked the staff to present a proposal for each required measurement at a future Board meeting.

b. If the entity intends to sell the asset in a relatively short period of time, an entity will not need to perform a present value calculation if market values/agreed selling prices are available. This simplifies the calculation. This simplification will not result in overstatement of assets since under IAS 36, the asset would never be written down lower than its fair value less costs to sell (due to the 'higher of' requirement).

c. By defining recoverable amount as the present value of the future cash flows expected to be derived from the use or the sale of the asset, we avoid confusion where there may be an intention to sell, but not in the immediate future. In this case, the present value calculation would consider cash flows both from the use and from the sale of the asset.

Question 26.1

Does the Board agree with the staff recommendation that the ED should be amended to use the term recoverable amount and that recoverable amount should be determined based on whether the asset is intended to be sold or used within the business as set out in the staff recommendation above?

Issue 26.2: Simplify requirements for assessing impairment of goodwill [Staff recommendation added from Agenda Paper 9C May 2008]

163. **Comment letters.** Simplify requirements for impairment of goodwill. Comment letters raised various issues regarding the approach in ED paragraphs 26.20-26.24. In general, respondents found those paragraphs difficult to understand. Few proposals for simplifications were suggested.

164. **Field tests.** Several entities have goodwill in their balance sheet, and several of them 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 or lack of

comparable companies with market transactions. Several entities feel that private entities should have the option to amortise goodwill.

165. **WG recommendation.** Many WG members felt that although guidance on measuring impairment of goodwill is necessary, the requirements proposed in the ED are very complex. However, while recommending that this be simplified in the final IFRS for Private Entities, WG members did not propose any specific simplifications.

166. **Staff comment:** The requirements in the ED would require a private entity to determine whether there is an indicator that goodwill is impaired (ED paragraphs 26.20–21). If impairment is indicated, then ED paragraph 26.22 is applied:

> 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.

167. **Staff recommendation.** Staff do not believe that the overall procedure set out in ED paragraph 26.22 is difficult to understand. However, staff recommend the following changes as practical simplifications for private entities that would assist private entities in applying the process in ED paragraph 26.22 while maintaining the basic approach in that paragraph:

   a. In 26.22 Step 1(a) add a presumption that goodwill relates to the acquired business in its entirety unless the acquired business has been restructured or dissolved into the parent or other subsidiaries. In other words, the only component of the group that benefits from the goodwill should be presumed to be the acquired business in its entirety. Therefore, any impairment of goodwill will be assessed based on the recoverable amount of the acquired business (where recoverable amount is defined as recommended by the staff in Issue 26.1). If there has been a restructuring or the acquired business has been dissolved into the parent or other subsidiaries, then goodwill should first be

allocated to components of the restructured group of entities for the purpose of assessing impairment. In many cases this presumption will simplify 26.22 Step 1(a) since the entity will not be required to perform an allocation of goodwill on acquisition.

b. Consider a slight rewording of 26.22 to make the steps easier to understand, for example add clear explanations for any new terminology (see Issue 26.3 below).

168. The main complexity identified by respondents comes from the requirement in 26.22 Step 1(b) to determine the fair value of the component. For example, if the component is an entire privately owned-subsidiary, often the fair value will be difficult to determine. To be consistent with Issue 26.1, staff recommend reintroducing the notion of recoverable amount as the objective of Step 1(b) above. Recoverable amount would be determined based on whether the component is intended to be sold or used within the business. As proposed in Issue 26.1, the fair value of the component would only need to be determined if a sale was planned. If there is no intention to sell, recoverable amount would be the present value of the future cash flows expected to be derived from use of the component (presumed to be the entire acquired business as proposed above). Staff recommend explaining in the IFRS for Private Entities that where the component is not intended to be sold, the present value calculation should be based on cash flow budgets approved by management. Hence if the component is the entire acquired business, the present value calculation should be based on cash flow budgets approved by management for that entire business.

169. Staff acknowledge that some private entities will not prepare cash budgets covering an extended future time period and, in any case, the longer the time period of the budget, the lower its reliability. Therefore, staff recommend that if the recoverable amount of a component cannot be determined reliably without undue cost or effort, then the entity should write off the total goodwill allocated to that component in full as an expense in measuring profit or loss. This treatment is consistent with requiring private entities to amortise goodwill over a short period as recommended by staff in Issue 18.1. The supporting arguments within the staff recommendation for Issue 18.1 are relevant here.

<u>Question 26.2A</u>

Does the Board agree with the staff recommendation that ED paragraph 26.22 Step 1(a) should be amended to include a presumption that if the acquired business has not been restructured or dissolved into the parent or other subsidiaries, the only component of the group that benefits from the goodwill is the acquired business?

<u>Question 26.2B</u>

If the Board agrees with the staff recommendation in Issue 26.1, does the Board also agree with the staff recommendation the term 'recoverable amount' should replace 'fair value' in the goodwill impairment test in Section 26 and guidance should be added to note that if the component is not intended to be sold, the present value calculation should be based on cash flow budgets approved by management?

<u>Question 26.2C</u>

Does the Board agree with the staff recommendation that the ED should be amended to specify that if the recoverable amount of a component cannot be measured reliably without undue cost or effort, then the entity should write off the total goodwill allocated to that component in full as an expense in measuring profit or loss?

Issue 26.3: Impairment – assessment by cash generating unit or component of an entity

170. **Comment letters.** Bring back the term 'cash generating unit' as this term is well understood. Use of new terminology 'component of the entity' (in ED paragraphs 26.22–26.23) and 'group of assets' (in ED paragraphs 26.5, 26.8, 26.9, 26.11, and 26.20) is confusing

171. **Field tests.** No related comments.

172. **WG recommendation.** WG members recommended that value in use should be assessed for a group of assets if it cannot be assessed for an individual asset. But do not use the term 'cash generating unit'. WG did not discuss 'component of an entity'.

173. **Staff comment.** ED paragraph 26.9 states:

     26.9 If an entity cannot estimate fair value for an individual asset, the entity shall measure the fair value less costs to sell for the group of assets to which the asset belongs. For this purpose, fair value less costs to sell shall be estimated for the smallest identifiable group of assets

     (a) that includes the asset for which impairment is indicated and

     (b) whose fair value less costs to sell can be estimated.

     'Group of assets' is used similarly in 26.5, 26.8, 26.11, and 26.20.

     'Component of an entity' is a different notion than a 'group of assets' or 'cash generating unit'. Component of an entity is used in the ED only in the context of testing goodwill for impairment. Even if 'group of assets' is replaced by 'cash generating unit', the notion of 'component of an entity' (or equivalent) will still be needed. 'Component of an entity' is a defined term in the ED glossary.

174. **Staff recommendation.** Staff believes that ED paragraph 26.9 is a cash-generating-unit approach without using that term. ED paragraph 26.3 contains a similar provision for inventories. Staff believes that adding clear explanations for the term 'group of assets' and 'component of the entity' is all that is needed in this regard.

Question 26.3

Does the Board agree with the staff recommendation that the ED already covers the concept of 'cash generating unit' and no change, other than to clarify the new terms used, is needed?

Section 27 Employee Benefits

Issue 27.1: Pensions – options for recognising actuarial gains and losses [Staff recommendation changed from Agenda Paper 9C May 2008 and staff reasoning amended from Agenda Paper 2B June 2008]

175. **Comment letters.** Allow other options for actuarial gains and losses, in particular recognition outside profit or loss, such as in equity or in other comprehensive income. Give private entities all of the options that an entity has using full IFRSs.

176. **Field tests.** Only a few field test entities commented but those who did noted that expensing all actuarial gains and losses only had a small effect on profit or loss. Therefore, these entities were indifferent to whether or not alternative options were allowed for actuarial gains or losses and they considered the approach in Section 27 the easiest.

177. **WG recommendation.** WG members would allow all options for actuarial gains and losses that are permitted by IAS 19 *Employee Benefits*.

178. **Staff comment.** Currently Section 27 requires immediate recognition in profit or loss of all actuarial gains and losses. IAS 19 allows the following four options for recognising actuarial gains and losses (IAS 19.92–19.93A):

a. Immediate recognition in profit or loss.

b. Immediate recognition in other comprehensive income and presentation in a statement of other comprehensive income.

c. So-called 'corridor approach' in IAS 19.92, briefly summarised as recognition in profit or loss of the amortisation, over the average working life of the employees participating in a plan, of (a) the excess of (i) 10% of the defined benefit obligation and (ii) 10% of plan assets over (b) cumulative unrecognised actuarial gains and losses.

d. Any other systematic method of amortisation that results in faster amortisation than the corridor approach.

179. **Staff recommendation.** Of the four methods allowed in IAS 19 for recognition of actuarial gains and losses, immediate recognition in profit or loss or in other comprehensive income are the simplest methods for private entities to implement as they do not require tracking of data over many years and annual calculations. In addition, financial statement users generally have told the Board that they find immediate recognition provides the most understandable and useful information. Staff also note that on 27 March 2008, the IASB published for comment a

Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* and one of the Board's preliminary views in this paper is to recognise all changes in the value of plan assets and in the post-employment benefit obligation in the financial statements in the period in which they occur. This would mean removing the options for deferred recognition of gains and losses in defined benefit plans.

180. However, due to the Board's decision at the May 2008 meeting that, in general, the accounting policy options in full IFRSs should be available to private entities staff recommend that the four methods allowed in IAS 19.92–93A be allowed as accounting policy options in the IFRS for Private Entities.

<u>Question 27.1</u>

Does the Board agree with the staff recommendation that the four methods for recognising actuarial gains and losses that are allowed in IAS 19.92–93A be allowed as accounting policy options in the IFRS for Private Entities?

Issue 27.2: Pensions – past service cost [Staff recommendation changed from Agenda Paper 9C May 2008 and staff reasoning amended from Agenda Paper 2B June 2008]

181. **Comment letters.** Allow deferral and amortisation of past service costs, in a manner consistent with what is permitted under IAS 19.

182. **Field tests.** No related comments.

183. **WG recommendation.** WG members would allow deferral and amortisation of unvested past service costs as in IAS 19 in addition to the proposed immediate expensing.

184. **Staff comment.** IAS 19.96 requires:

> **Past service cost**
>
> 96. In measuring its defined benefit liability under paragraph 54, an entity shall, subject to paragraph 58A, recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an entity shall recognise past service cost immediately.

185. **Staff recommendation.** In ED paragraphs 27.19 and 27.22(e), the Board proposed that all past service cost should be immediately charged to expense. The Board made that proposal for two reasons. First, this is a genuine simplification for private entities from the amortisation approach in IAS 19.96. Second, immediate expensing was consistent with the proposal in the ED that all actuarial gains and losses be recognised immediately as an expense in profit or loss (see Issue 27.1). Staff also note that in the Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* one of the Board's preliminary views was that unvested past service cost should be recognised in the period of a plan amendment. Nevertheless, due to the Board's decision at the May 2008 meeting that, in general, the accounting policy options in full IFRSs should be available to private entities, the staff recommendation in Issue 27.1 is to include in the IFRS

for Private Entities the four accounting policy options in IAS 19 for actuarial gains and losses. Consistent with that recommendation, the staff recommends changing the proposed requirement for past service cost in the ED to conform to the principle in IAS 19.96 so that (a) vested past service cost is immediately recognised in profit or loss and (b) unvested past service cost is recognised as an expense on a straight-line basis over the average period until the benefits become vested. This would be reflected by changing ED paragraphs 27.19 and 27.22(e). Staff does not support introducing an accounting policy option by offering a choice of (a) either immediate expensing of all past service cost as proposed in the ED or (b) the IAS 19.96 approach.

Question 27.2

Does the Board agree with the staff recommendation to change ED paragraphs 27.19 and 27.22(e) to conform to the principle in IAS 19.96, so that (a) vested past service cost is immediately recognised in profit or loss and (b) unvested past service cost is recognised as an expense on a straight-line basis over the average period until the benefits become vested?

Issue 27.3: Pensions – Measurement at current liquidation amount [For ease of Board discussion, Issues 27.3 and 27.4 in Agenda Paper 9C May 2008 have been reversed in this Agenda Paper. Staff recommendation has been added since Agenda Paper 9C May 2008 and amended since Agenda Paper 2B June 2008.]

186. **Comment letters.** Measure as if all employees would retire as of the reporting date (that is, at current liquidation amount) based on current salaries.

187. **Field tests.** 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 ED paragraph 27.16 for defined benefit plans.

188. **WG recommendation.** Most WG members would encourage the Board to simplify the calculation of defined benefit obligations. Some WG members suggested that the calculation could be simplified by measuring the obligation on the basis that all employees would retire at the reporting date.

189. **Staff recommendation.** Staff recommend that an ‘undue cost or effort’ exemption should be added to the requirement to apply defined benefit accounting when determining the defined benefit obligation of a defined benefit plan for private entities. In other words, Section 27 should state that when sufficient information is not available without undue cost or effort for an entity to determine the present value of its defined benefit obligation and related current service cost under a defined benefit plan using the projected unit credit method, then that entity should measure the defined benefit obligation of that plan at the current liquidation amount using current salary information. Guidance should be provided so that the ‘undue cost or effort’ exemption is applied appropriately. This exemption applies to the determination of the defined benefit obligation only and hence the entity would determine the fair value of plan assets in the usual way. Staff feel that the current liquidation amount is an appropriate simplification and

provides users with useful information. If the exemption is taken, adequate disclosure about the defined benefit plan should be provided to supplement the current liquidation amount.

190. Staff acknowledge that defined benefit accounting provides useful information for users of financial statements. Staff does not propose a disclosure only requirement for defined benefit plans due to concerns about off balance sheet obligations. However, staff feel that defined benefit accounting can be complex and costly for private entities and may not be applied correctly unless specialists are used. Staff note that if the private entity only has a few employees, an assessment using the projected unit method would not be appropriate. Therefore, staff propose adding an 'undue cost or effort' exemption, similar to that used for fair value measurement of biological assets (ED paragraph 35.1). Staff note for entities with relatively few employees, current liquidation amount would approximate the defined benefit obligation and, in any case, for the majority of entities the current liquidation amount would tend to overstate rather than understate the defined benefit obligation.

Question 27.3

Does the Board agree with the staff recommendation to amend the ED to state that if sufficient information is not available without undue cost or effort to determine the present value of the defined benefit obligation and related current service cost under a defined benefit plan using the projected unit credit method, an entity should measure the defined benefit obligation of that plan at the current liquidation amount using current salary information and give supplementary disclosures?

Issue 27.4: Pensions – allow choice of actuarial method [Staff recommendation has been added since Agenda Paper 9C May 2008]

191. **Comment letters.** 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. Clarify that updating prior period valuations for changes in circumstances can result in reasonable measurements.

192. **Field tests.** See Issue 27.3.

193. **WG recommendation.** Most WG members would encourage the Board to seek simplify the calculation of defined benefit obligations.

194. **Staff comment.** The Board's decision on Issue 27.3 will affect the outcome of the Board discussion on this issue.

195. **Staff recommendation.** If the Board agree with the staff recommendation in Issue 27.3 to allow use of the current liquidation amount if sufficient information is not available without undue cost or effort to apply defined benefit accounting when determining the defined benefit obligation of a defined benefit plan, then staff do not feel there is any need to provide further simplification by allowing actuarial methods other than the projected unit credit method to be used.

196. Staff recommend clarifying the following where defined benefit accounting is performed:

a. An actuarial valuation performed by an outside actuary is not required every year since often a roll forward of the valuation would be appropriate if actuarial assumptions are relatively constant. Staff recommend providing guidance for private entities on when a roll forward is appropriate and how it should be performed.

b. For group plans, subsidiaries should be permitted to recognise a charge based on a reasonable allocation of the group charge if the parent prepares consolidated financial statements in accordance with either IFRS for Private Entities or full IFRSs since accounting for group plans can be complex and may add little informational value if the obligation is shared by many group entities. The basis of allocation should be disclosed.

Question 27.4A

If the Board agrees with the staff recommendation in Issue 27.3 above, does the Board also agree with the staff recommendation that there is no need to provide further simplification by allowing actuarial methods other than the projected unit method to be used for defined benefit accounting?

Question 27.4B

Does the Board agree with the staff recommendation that additional clarification should be added to the ED to state that under defined benefit accounting, an actuarial valuation performed by an outside actuary is not required to be done every year and that guidance should be added on when a roll forward is appropriate and how it should be performed?

Question 27.4C

Does the Board agree with the staff recommendation that additional clarification should be added to the ED to state that subsidiaries are permitted to recognise a charge based on a reasonable allocation of the group charge if the parent prepares consolidated financial statements under either IFRS for Private Entities or full IFRSs but the basis of allocation should be disclosed?

Issue 27.5: Pensions – treat all multi-employer as defined contribution

197. **Comment letters.** Treat all multi-employer plans as defined contribution.

198. **Field tests.** No related comments.

199. **WG recommendation.** Most WG members would encourage the Board to seek simplify the calculation of defined benefit obligations. Some WG members would simplify calculations by treating all multi-employer plans as defined contribution.

200. **Staff comment.** The ED proposes that multi-employer 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 a private entity can use defined contribution accounting, with disclosure.

201. **Staff recommendation.** Staff recommend allowing all multi-employer plans to be treated as defined contribution plans with appropriate disclosure (i.e. the nature of the plan and its funding arrangements) for cost benefit reasons. It is usually difficult to obtain the information necessary to apply defined benefit accounting in the financial statements of the participating employers since many of

arrangements effectively share the obligation amongst participating employers without providing detailed information about underlying assets and liabilities. In particular the cost and difficulty of obtaining this information may be significant for smaller private entities.

> ***<u>Question 27.5</u>***
>
> ***Does the Board agree with the staff recommendation that the ED should be amended to state that all multi-employer plans should be treated as defined contribution plans with appropriate disclosure?***

Section 28 Income Tax

Issue 28.1: Income Taxes – which method? [Staff recommendation added since Agenda Paper 9C May 2008]

202. **Comment letters.** 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.

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

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

    b. Problems measuring temporary differences. Measurements in the field test entity’s restated financial statements are ‘rough’ or are not finalised.

    c. The concept of recognising a deferred tax asset is not practical for private entities since private entities 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

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

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

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

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

204. **WG recommendation.** WG members did not express a clear consensus on how private entities should account for income taxes; however the majority felt that the requirements as proposed in the ED are too complex for private entities. More WG members leaned toward the taxes payable method than any other method, supported by some note disclosures about tax deferrals. More WG members favoured a timing difference approach than the proposed temporary difference approach as a simplification because comparing the income statement and the tax return is relatively straightforward. There was also support for either not recognising deferred tax assets at all or restricting deferred tax assets to those that are deemed to be realisable in the very short term such as one or two years, because private entities often do not have accurate cash flow budgets.

205. **Staff recommendation.** Staff recommend that the taxes payable method is required for private entities on the grounds of cost-benefits. This is one of the most common areas of the ED that is highlighted by respondents as complex and burdensome. Requiring the taxes payable method would be seen as a significant concession and would significantly increase acceptance of the IFRS for Private Entities. Staff also note that South Africa have adopted the ED word for word as South African GAAP (effective 2007) and to date deferred tax has been one of the only two significant problem areas that have arisen on application. Staff recommend that this method is supplemented by appropriate disclosures in order to provide users with relevant information on deferred taxes. Such disclosure, at a minimum, would include information on the implication of temporary differences arising in the current period that will have an impact on the amount paid to or recovered from authorities. Staff support the taxes payable approach for private entities for the following reasons:

a. Deferred tax is an area that is not well understood by both preparers and users of private entity financial statements. The deferred tax requirements may be applied incorrectly if they are not clearly understood. Also many users of private entity financial statements are less sophisticated than users of listed entity financial statements and will often be unable to appreciate the significance of deferred tax information. Accounting for taxes using the taxes payable method with appropriate clear and simple disclosures of relevant information on the impact of temporary differences is likely to be applied well by private entities and will be better understood by many users. Therefore, in many cases, this will lead to more accurate and useful information.

b. The continual tracking in subsequent years of the values of deferred tax assets and liabilities, once determined, is very expensive and would require

substantial organisational effort. Private entities often have limited resources so will find such requirements burdensome.

c. Some respondents feel that since the proposals prohibit discounting for deferred taxes, this could lead to large assets or liabilities that do not necessarily reflect the underlying economics of an entity's tax position or allow users of financial statements to predict tax cash flows in the future.

d. Private entities would not be prohibited from provided additional detailed disclosure about deferred taxes in the notes to their financial statements.

Question 28.1

Does the Board agree with the staff recommendation that the ED should be changed to require that the taxes payable method is applied by private entities on the grounds of cost-benefits, supplemented by suitable disclosures?

Section 29 Financial Reporting in Hyperinflationary Economies

Issue 29.1: Existence of hyperinflation

206. **Comment letters.** 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 *Financial Reporting in Hyperinflationary Economies*, rather than just having the numerical test that cumulative inflation over 3 years should approach or exceed 100 per cent.

207. **Field tests.** No related comments as not relevant to any of the field test entities.

208. **WG recommendation.** Not discussed.

209. **Staff recommendation.** Staff recommend all of the criteria for assessing if an economy is hyperinflationary in IAS 29.3 should be added to Section 29 to ensure a consistent approach in each country. The purely numerical approach to identifying whether there is a hyperinflationary economy in the ED (ie 100 per cent in 3 years) may give a different answer to IAS 29's more judgmental approach. Also staff feel there is no need to simplify the characteristics for private entities since whether or not a country is considered to be experiencing hyperinflation is generally determined by a consensus of the accounting profession, rather than by each entity individually. It would be simpler for private entities to use the same criteria and reach the same outcome to determine existence of hyperinflation as used by publicly accountable entities operating in that economy. Staff note that, at the May 2008 meeting, the Board decided to bring hyperinflation into the IFRS for Private Entities, rather than addressing it by cross-reference to IAS 29.

Question 29.1

Does the Board agree with the staff recommendation that all of the IAS 29 characteristics of hyperinflation should be added to Section 29?

Section 30 Foreign Currency Translation

Issue 30.1: Foreign currency translation – if financial statements must be presented in the national currency can that be the functional currency

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

211. **Field tests.** Private entities 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.

212. **WG recommendation.** Where the law requires that financial statements must be presented in the national currency, WG members would allow that national currency to be deemed as the functional currency.

213. **Staff recommendation.** Staff agree with the WG recommendation. Staff acknowledge that, in the unusual case where a private entity's functional currency is not its national currency, presenting financial statements in the true functional currency would provide information about the entity that better reflects the economic substance of the underlying events and circumstances relevant to that entity. However, staff feel for cost-benefit reasons there should be an exemption from presenting financial statements in the true functional currency when law requires financial statements to be presented in the national currency and this is not the same as the functional currency. For private entities, such an exemption would significantly reduce the costs without significantly reducing the usefulness of the information presented.

<u>Question 30.1</u>

Does the Board agree with the staff recommendation that the ED should be amended to state where the law requires that financial statements must be presented in the national currency, private entities should be given the option to deem the national currency as their functional currency?

Issue 30.2: Translation – recycling of cumulative exchange difference in equity

214. **Comment letters.** Do not require, or possibly even prohibit, recognition of cumulative exchange differences deferred in equity in profit and loss when the gain or loss on disposal of a foreign operation is recognised, to avoid the administrative burden of tracking historical exchange rates.

215. **Field tests.** No related comments.

216. **WG recommendation.** WG members would leave cumulative exchange differences in equity on disposal of a foreign operation.

217. **Staff recommendation.** Staff recommend that private entities should be prohibited from recycling cumulative exchange differences due to the significant administrative burden needed to track such historical exchange differences. Staff do not recommend that private entities are given the option to recycle such exchange differences. Staff feel that simplification should have precedence over comparability with full IFRSs. At the May 2008 meeting, the Board decided that the IFRS for Private Entities should reflect the requirements of IAS 1 (2007) *Presentation of Financial Statements*. This means that private entities will be

presenting a statement of comprehensive income, making recycling less of an issue.

<u>***Question 30.2***</u>

Does the Board agree with the staff recommendation that the ED should be amended to prohibit private entities from recycling cumulative exchange differences deferred in equity in profit and loss when the gain or loss on disposal of a foreign operation is recognised?

Section 33 Related Party Disclosures

Issue 33.1: Related parties – disclosure of sensitive information

218. **Comment letters.** Section 33 should be amended for the requirements in the Exposure Draft of Amendments to IAS 24 *Related Parties* if that amendment is finalised before the IFRS for Private Entities is issued.

219. **Field tests.** No related comments.

220. **WG recommendation.** Not discussed.

221. **Staff comment:** Several other issues relating to Section 33 were raised. Other Section 33 issues will be covered together with other disclosure issues in later Board papers.

222. **Staff recommendation.** Staff recommend that the Exposure Draft of Amendments to IAS 24 is considered if finalised before the IFRS for Private Entities is completed for the following reasons:

a. The main objective of the proposed changes to IAS 24 is to reduce disclosure requirements for some entities that are related only because they are each state-controlled or significantly influenced by the state. This issue is relevant to private entities in such jurisdictions. Reducing disclosure requirements is in line with the objective of simplification of requirements for private entities.

b. The Proposed Amendments to IAS 24 also intend to improve the wording used in IAS 24, in particular to make the definition of a related party easier to understand and interpret. In many cases Section 33 adopts the same or similar wording to IAS 24 and the IAS 24 definition of a related party is used. Hence, considering the changes in the final amendments to IAS 24 may lead to simplification.

c. The Proposed Amendments are intended to rectify some inconsistencies in IAS 24 and, hence, those inconsistencies should also be amended in the IFRS for Private Entities.

<u>***Question 33.1***</u>

Does the Board agree with the staff recommendation that the final amendments to IAS 24 should be reflected in the IFRS for Private Entities?

Section 35 Specialised Industries

Issue 35.1: Agriculture – allow cost model as an option

223. **Comment letters.** 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.

224. **Field tests.** 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.

225. **WG recommendation.** WG members felt that the addition of an 'undue cost or effort' criterion for use of fair value of agricultural assets is appropriate and, therefore, the approach in Section 35 should not be changed.

226. **Staff comment.** ED paragraph 35.1 sets out the following approach

> 35.1 An entity using this [draft] standard that is engaged in agricultural activity shall determine, for each of its biological assets, whether the fair value of that biological asset is readily determinable without undue cost or effort:
>
> (a) The entity shall apply the fair value model in paragraphs 10–29 of IAS 41 Agriculture to account for those biological assets whose fair value is readily determinable without undue cost or effort, and the entity shall make all related disclosures required by IAS 41.
>
> (b) The entity shall measure at cost less any accumulated depreciation and any accumulated impairment losses those biological assets whose fair value is not readily determinable without undue cost or effort. The entity shall disclose, for such biological asset(s)....

227. **Staff recommendation.** Staff agree with the WG recommendation that the current approach in Section 35 provides appropriate simplification for a private entity and there is no need to allow the cost model as an accounting policy choice for the following reasons:

a. For agriculture, measurement at fair value is normally considered to be a simpler requirement than measurement at cost. Quoted prices are often readily available, markets are active, and measuring cost is usually more burdensome and arbitrary because of the extensive allocations required.

b. Fair value is generally regarded as a more relevant measure in this industry. Managers of most private entities that undertake agricultural activities say that they manage biological assets on the basis of market prices or other measures of current value rather than historical costs. Users also question the meaningfulness of allocated costs in this industry.

c. Staff acknowledge in some cases fair values may not be available, particularly when applied to biological assets of those private entities operating in inactive markets or developing countries. However staff feel that the 'undue cost or effort' criterion caters adequately for such situations. Staff feel that more guidance may be necessary to ensure the 'undue cost or effort' criterion is applied appropriately.

<u>Question 35.1</u>

Does the Board agree with the staff recommendation that the ED should not be amended to provide the cost model as an accounting policy choice for agricultural private entities and that the requirement to apply fair value measurement, with an 'undue cost or effort' criterion as proposed in the ED is a sufficient simplification for private entities?

Section 36 Discontinued Operations and Assets Held for Sale

Issue 36.1: Eliminate held for sale classification

228. **Comment letters.** 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 *Property, Plant and Equipment*. Others said that holding an asset for sale could just be treated as an impairment indicator under Section 26 *Impairment of Non-financial Assets*, which would automatically trigger an impairment assessment and calculation.

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

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

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

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

230. **WG recommendation.** WG members felt there is no need for a held for sale classification for private entities. Instead the impairment requirements in the individual sections of the IFRS for Private Entities cover this. The only substantive difference would be continued depreciation of non-current assets held for sale.

231. **Staff recommendation.** Staff agree with the WG recommendation for cost-benefit reasons. Staff notes that the impairment requirements in the ED would ensure that assets are not overstated in the financial statements, and this should be clarified by adding the decision to sell an asset (group of assets) in the near future as an indicator of impairment. Staff acknowledge that information on assets and liabilities identified for disposal in the near future is useful to users. However in most cases the needs of users of private entity financial statements would be met by simple narrative disclosures, removing the need for the additional 'held for sale' category and its relatively complex measurement requirements.

Question 36.1

Does the Board agree with the staff recommendation that there should be no 'held for sale' classification and hence the requirements for assets held for sale should be dropped from Section 36 – instead the decision to sell an asset should be added to Section 26 as an impairment indicator?

Issue 36.2: Discontinued operations – simplify or eliminate this disclosure

232. **Comment letters.** Simplify (or even eliminate) discontinued operations disclosures and restatements.

233. **Field tests.** See comments for Issue 36.1 above.

234. **WG recommendation.** WG members recommended that prior period financial statements not be restated to segregate a discontinued operation.

235. **Staff comment:** If both the discontinued operation disclosures and the held for sale classification are removed from the IFRS for Private Entities, Section 36 can be totally eliminated.

236. **Staff recommendation.** Staff agree with the WG recommendation that, for private entities, disclosure and segregation of information on a discontinued operation should be limited to the current period. Restated information for prior years should be encouraged but not required. Restatement of prior years is burdensome and is less important for private entities since their financial statements are not usually subject to the same level of scrutiny, for example by analysts, as financial statements of publicly accountable entities. Some private entities will have limited resources to perform such a restatement.

237. Staff do not think the requirement to provide information on discontinued operations in the current year is too onerous since most private entity business environments are stable and constant changes due to investments and divestitures undergone by large multinational entities are not typical. Hence, the requirement to show information for discontinued operations for the current year is likely to be a one-off rare requirement for private entities.

238. Staff feel that if these changes and the recommendations in Issue 36.1 for held for sale items are adopted, then Section 36 can be deleted and the remaining requirements for disclosure of a discontinued operation can be added to the section of the IFRS for Private Entities dealing with the statement of comprehensive income (Section 5 of the ED). Staff note that the definition of a discontinued operation currently refers to assets held for sale and so the definition will need to be rewritten if the held for sale classification is dropped.

Question 36.2

Does the Board agree with the staff recommendation that the ED should be amended so that disclosure and segregation of information on discontinued operations is limited to the current period only and such requirements should be added to the section of the IFRS for Private Entities dealing with the statement of comprehensive income?

Section 38 Transition to the *IFRS for SMEs*

Issue 38.1: First-time adoption of the IFRS for Private Entities – include all IFRS 1 exemptions

239. **Comment letters.** The majority of respondents were happy with the approach in Section 38. However, a significant number of these suggested modifications. One frequent suggestion is to include all of the IFRS 1 optional exemptions for first time adopters, including:

   a. parent and subsidiary adopt at different times, and

   b. deemed cost for investment property and intangibles.

240. **Field tests.** No related comments.

241. **WG recommendation.** WG members were generally happy with the approach in Section 38. Most WG members would include in Section 38 all of the IFRS 1 optional exemptions for first time adopters.

242. **Staff recommendation.** Staff agree with WG recommendation since the IFRS for Private Entities should not be more restrictive in this area than full IFRSs. Staff recommend all of the IFRS 1 optional exemptions that relate to requirements in the IFRS for Private Entities should be included in Section 38.

<u>Question 38.1</u>

Does the Board agree with the staff recommendation that 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) should be added to Section 38 so they are available to private entities adopting the IFRS for Private Entities for the first time?

Issue 38.2: First-time adoption – relax use of 'impracticable' [Staff recommendation changed from Agenda Paper 9C May 2008]

243. **Comment letters.** Relax the use of 'impracticable' in ED paragraph 38.9 – that is, provide an exemption from restatement at a far lower hurdle than the 'impracticable' exemption in full IFRSs.

244. **Field tests.** 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 private 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.

245. **WG recommendation.** WG members generally favoured adding an 'undue cost or effort' exemption from the requirement to restate prior periods (a lower hurdle than 'impracticable').

246. **Staff comment.** ED paragraph 38.9 states:

38.9 If it is impracticable for an entity to restate the opening balance sheet at the date of transition in accordance with this [draft] standard, the entity shall apply paragraphs 38.5–38.8 in the earliest period for which it is practicable to do so, and shall disclose the date of transition and the fact that data presented for prior periods are not comparable. If it is impracticable for an entity to provide any disclosures required by this [draft] standard for any period before the period in which it prepares its first financial statements that conform to this [draft] standard, the omission shall be disclosed.

247. Whether an 'undue cost or effort' principle should be added wherever the IFRS for Private Entities requires restatement was discussed at the May 2008 Board meeting (Issues G11 in Agenda Paper 9A for the May meeting). At that meeting the Board decided that an 'undue cost or effort' principle should not be added wherever the standard requires restatement. The exemption for 'impracticability' was considered sufficient.

248. **Staff recommendation.** Given the Board's decision on Issue G11, staff recommend that an 'undue cost or effort' principle should not be added to the impracticability exemption in ED paragraph 38.9.

Question 38.2

Does the Board agree with the staff recommendation that an 'undue cost or effort' principle should not be added to the impracticability exemption for the requirement to restate prior periods on first-time adoption of the IFRS for Private Entities?

Issue 38.3: Make it easier to move to/from the IFRS for Private Entities

249. **Comment letters.** Relax the requirements to allow an entity to move to and from the IFRS for Private Entities (maybe more than once). On the other hand, a number of respondents were concerned about entities switching between the IFRS for Private Entities and another accounting framework more than once. Some said that this may be a matter best left to each jurisdiction to decide.

250. **Field tests.** No related comments.

251. **WG recommendation.** Some WG members felt that it might not be a rare situation for an entity to find itself in the position of moving in and out of the category of entities required or permitted to apply IFRS for Private Entities, particularly if a jurisdiction adds a quantified size test. Those WG members felt, therefore, that Section 38 should be available to entities on transitioning to the IFRS for Private Entities on more than one occasion.

252. **Staff comment.** Section 38 applies only to a first-time adopter of the IFRS for Private Entities. So, as written, an entity could not take advantage of the special measurement and restatement exemptions in Section 38 (similar to those in IFRS 1) more than once. Staff can envision three circumstances in which an entity might potentially be in a circumstance to adopt the IFRS for Private Entities more than once:

a. The entity uses the IFRS for Private Entities, switches to full IFRSs (either because it became publicly accountable or by choice) and subsequently is no longer publicly accountable (most likely due to 'delisting') or no longer

chooses to use full IFRSs and so wants to re-adopt the IFRS for Private Entities.

b. The jurisdiction in which the entity is located requires or allows the IFRS for Private Entities only for entities that exceed a specified size threshold (very small entities are prohibited). The entity exceeds the threshold and, accordingly, switches from its national GAAP to the IFRS for Private Entities. Subsequently the entity falls below the threshold and, either by regulation or by choice, switches back to its national GAAP. Subsequently the entity is once again above the threshold where the IFRS for Private Entities is required or permitted, and the entity wants to re-adopt the IFRS for Private Entities.

c. The jurisdiction in which the entity is located requires or allows full IFRSs for large-sized non-publicly accountable entities (for instance, entities that are regarded as 'economically significant'), and allows or requires the IFRS for Private Entities for smaller entities. Initially the entity is not above the 'economically significant' threshold and so uses the IFRS for Private Entities. Subsequently it exceeds the jurisdiction's size threshold for full IFRSs, and accordingly switches from the IFRS for Private Entities to full IFRSs. Subsequently it falls below the 'economically significant' threshold and, by regulation or by choice, wants to re-adopt the IFRS for Private Entities.

Staff believe that situations (a) and (c) – both of which involve an entity switching from full IFRSs to the IFRS for Private Entities – will occur only in extremely rare circumstances. Situation (b) – will still be rare, but perhaps not as rare as situations (a) and (c).

253. **Staff recommendation.** Section 38 does not prohibit an entity from adopting the IFRS for Private Entities more than once. What it does is offer certain special exemptions, along with a few special prohibitions, to a first-time adopter. Section 38 offers those exemptions for the same reasons that IFRS 1 offered similar exemptions – to reduce the burden of making the transition and to ensure that the effect of the transition is disclosed. Because of the rarity of the instances of an entity adopting the IFRS for Private Entities twice, staff do not recommend allowing an entity to use the exemptions in Section 38 more than once.

Question 38.3

Does the Board agree with the staff recommendation that an entity should not be allowed to benefit from the special measurement and restatement exemptions available under Section 38 more than once?