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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: **June 2008, London**

Project: **IFRS for Private Entities (formerly IFRS for SMEs)**

Subject: **Redeliberation – Issues Relating to ED Sections 11 to 38
(Agenda Paper 2B)**

1. For the June 2008 Board meeting, the SME agenda papers are organised as follows:
 - **Agenda Paper 2** – Overview
 - **Agenda Paper 2A** – Issues Relating to ED Sections 1-10
 - **Agenda Paper 2B** – Issues Relating to ED Sections 11-38
2. This agenda paper (Agenda Paper 2B) sets out issues relating to Sections 11-38 in the Exposure Draft (ED) of a proposed IFRS for SMEs. It is based on Agenda Paper 9C for the May 2008 Board meeting. Agenda Paper 9C included issues and staff recommendations for most but not all of Sections 11-38. This June paper includes issues and recommendations for all of the sections. Where this paper has added an issue or a recommendation or has changed an issue or recommendation from the May paper, that is noted in [square brackets] in the title of the issue (see, for instance, the heading for Issue 15.2 immediately above paragraph 120 of this agenda paper). All of the issues relating to Section 11 have been newly added since Agenda Paper 9C and hence, for this section only, this is noted in [square brackets] in the heading directly beneath paragraph 4, rather than repeated in the title of each Section 11 issue. Any additional staff comments and non-substantive wording changes are not highlighted.
3. As with the May 2008 agenda papers, the issues are numbered sequentially by section number, so the first issue for Section 12 is Issue 12.1, 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.

4. Because it is an update of Agenda Paper 9C for May 2008, this agenda paper continues to use the terms 'SMEs' and 'IFRS for SMEs'. Staff did not update those terms due to their frequency in this agenda paper. Future Board papers will reflect the Board's decision in May 2008 to change the title of the standard from IFRS for SMEs to IFRS for Private Entities.

Section 11 Financial Assets and Financial Liabilities [All issues in this section have been added since Agenda Paper 9C May 2008]

Issue 11.1: Restructure Section 11 to make it easier to understand and easier to identify to what instruments it applies

5. **Comment letters.** In particular for Section 11, respondents requested that the language should be simplified, the structure improved, and requirements should be made explicit, not implicit (for example, for derivatives). Although the specific details for change proposed by respondents differed, concerns that Section 11 is too complex were raised in a nearly two dozen letters of comment.
6. **Field tests.** Many field test entities did not apply Section 11 as they have a misconception that Section 11 is only relevant for entities with complex financial instrument activities, such as hedging. Some field test entities feel it is not apparent, for instance, that plain receivables and payables are also addressed in Section 11 (the list in ED paragraph 11.2 notwithstanding). Nor is it clear to an SME that 'impairment of financial instruments measured at cost or amortised cost' covers bad debts. Some field test entities noted clarification of the transactions addressed in this section is necessary to overcome this problem, for instance by using simpler language and reorganising the Section 11 to address simple financial instruments first.
7. There were also problems deciding whether certain instruments are within the scope of Section 11. As examples, field test reports cited statutory obligations (such as tax obligations), provisions for contingent consideration, and government grants in the form of repayable advances.
8. **WG recommendation.** Before discussing possible changes to Section 11, the WG considered a short presentation by one of the Board members explaining the rationale for the approach that is taken in Section 11. This approach classifies financial instruments according to their cash flow characteristics, thus avoiding the need to define such instruments as derivatives and embedded derivatives, held-to-maturity, and available-for-sale. Also, by making fair value through profit or loss the default classification, Section 11 avoids having to list out all of the specific instruments, or detailed characteristics of instruments, that need to be measured at fair value. Such a list would be lengthy but necessary to avoid the potential for inappropriate accounting.
9. WG members generally acknowledged the rationale of this approach. However, they expressed serious concern that the approach appears unnecessarily complex, particularly for an SME that has only 'plain vanilla' financial instruments such as normal receivables and payables and related bad debts and factoring. WG members felt that the approach of using 'fair value for all financial instruments

except' sends completely the wrong message since, for the vast majority of SMEs, the reality will be the cost model. WG members felt strongly that by not defining cost or amortised cost as the default, this approach appears to require an SME to account for significantly more instruments at fair value through profit or loss than even IAS 39. WG members generally recommended the following changes to Section 11:

- a. The rationale behind the approach taken in Section 11 should be explained at the outset in as simple terms as possible. It should be clear that the cost model will be appropriate for the significant majority of financial instruments held by SMEs.
- b. Section 11 should be reorganised to make it easier to apply by an SME that only has very simple financial instruments. In other words Section 11 could be restructured to distinguish between simple (and common) financial instruments and all others. That could be done, for instance, by adding, up front, examples of the typical kinds of financial instruments that an SME is likely to have, with clear guidance for the accounting required both at acquisition/issuance and subsequently. An SME that has no other financial instruments would then not need to even consider the criteria in ED paragraph 11.7.
- c. Section 11 should be rewritten so that a cost model (cost or amortised cost) is the default – that is, 'cost or amortised cost shall be used for all financial instruments except'.
- d. The examples of instruments that would be accounted for at cost or amortised cost as listed in ED paragraph 11.10 should be linked to the criteria in ED paragraph 11.7, and accounting for them should be described in greater detail.
- e. Include a clear description of the cost and amortised cost models.
- f. The guidance on fair value in Appendix B to Section 11 is too complex for most SMEs. Rewrite to aim the content at the target audience. Or delete Appendix B entirely because the principles are already set out in ED paragraphs 11.14 to 11.16.

10. **Staff recommendation.** Staff recommend that Section 11 should be amended in the following ways:

- a. Clarify by use of examples that the cost model will be appropriate for the significant majority of financial instruments held by SMEs. This could be accomplished by expanding and elaborating on the examples that are already cited in ED paragraph 11.10.
- b. Reorganise Section 11 to make it easier both to identify which instruments are within the scope and to apply by an SME that only has very simple financial instruments:
 - i. Restructure Section 11 to distinguish between simple (and common) financial instruments and all others.
 - ii. Add, up front, examples of the typical kinds of financial instruments that an SME is likely to have, with clear guidance for the accounting required both at acquisition/issuance and subsequently. An SME that has no other financial instruments

would then not need to even consider the criteria in ED paragraph 11.7.

- c. Rewrite Section 11 so that a cost model (cost or amortised cost) is the default – that is, ‘cost or amortised cost shall be used for all financial instruments except’.
- d. Link the examples of instruments that would be accounted for at cost or amortised cost as listed in ED paragraph 11.10 to the criteria in ED paragraph 11.7, and accounting for them should be described in greater detail.
- e. Include a clear description of the cost and amortised cost models.
- f. The guidance on fair value in Appendix B to Section 11 should be combined with the fair value measurement principles set out in ED paragraphs 11.14 to 11.16 and simplified in an SME context. Appendix B could then be deleted.

Question 11.1

Does the Board agree with the staff recommendation for how to amend Section 11 as set out in (a) to (f) of paragraph 10 directly above?

Issue 11.2: Split Section 11 into two sections

11. **Comment letters.** Commentators suggested splitting Section 11 into two sections roughly along the following lines:
 - a. One would deal only with ‘plain vanilla’ financial instruments – such as cash, bank deposits, accounts receivable, accounts payable, normal loans payable, bad debts, factoring, and related disclosures.
 - b. The other would deal with all of the other issues, including investments, bonds, asset backed securities, options, warrants, futures, forwards, swaps, derecognition, hedge accounting, and related disclosures.
12. **Field tests.** No related comments.
13. **WG recommendation.** Did not discuss. But as noted under Issue 11.1, WG members recommended that Section 11 should be reorganised to make it easier to apply by an SME that only has very simple financial instruments.
14. **Staff recommendation.** If Section 11 is reorganised as recommended under Issue 11.1, it is not necessary to split Section 11 into two sections. Financial asset and financial liability are glossary terms. If Section 11 were split, new definitions would be needed to distinguish those financial assets and financial liabilities that are covered in the first (‘plain vanilla’) section from those covered in the second section. Staff believe this would unnecessarily complicate the standard.

Question 11.2

Does the Board agree with the staff recommendation that if Section 11 is reorganised as recommended under Issue 11.1, it is not necessary to split Section 11 into two sections?

Issue 11.3: Default measurement basis for financial instruments

15. **Comment letters.** Make cost the default measurement basis, not fair value.
16. **Field tests.** Some field test entities said cost should be the default category, with fair value only rarely applied. Many field test entities found it difficult to determine which financial instruments can be measured at amortised cost as they found ED paragraph 11.9 difficult to understand. Some field test entities recommended that ED paragraph 11.9 should be set out more simply and clearly to help understanding. Only a few field test entities actually stated which instruments they had particular problems classifying, and these were interest-free trade receivables and payables and interest-free intercompany loans, as entities are unsure if they meet the requirement to have a fixed rate of return under ED paragraph 11.9(b).
17. Many field test entities feel the fair value requirements in the ED require undue cost or effort. Some field test entities measured all financial instruments at cost due to difficulties applying fair value. Some of the more significant issues noted by field test entities as to why they were unable to, or did not want to, fair value or encountered difficulties applying fair value measurement requirements include:
 - a. Use of external experts is not financially possible for SMEs.
 - b. Asset base is too small to justify cost of calculating fair value annually.
 - c. Fair value measurements of non-quoted instruments result in undue cost and effort, in excess of benefits.
 - d. No reliable measure of fair value for certain instruments.
 - e. Appendix B, covering fair value measurement, is difficult to understand and often not relevant. Practical examples are necessary.
 - f. It's unclear how to determine whether a market is active or inactive. Further guidance is needed. For example, shares and debt instruments listed on the stock market in certain countries often trade infrequently, so fair value measurements may not be reliable even for 'quoted' instruments.
 - g. Fair value measurement of derivatives is difficult and so was not performed. A valuation should have been performed by an expert, but this was not done due to cost. However, a few field test entities that highlighted this point said it should not be an issue going forward, if applied on a regular basis, as the bank that provided the derivative should be able to provide a valuation.
18. **WG recommendation.** Section 11 should be rewritten so that a historical cost model (cost or amortised cost) is the default – that is, 'cost or amortised cost shall be used for all financial instruments except'.
19. **Staff recommendation.** Earlier as part of Issue 11.1 staff has recommended rewriting Section 11 to make cost the default measurement basis for financial instruments. There is no need for a further staff recommendation here.

Issue 11.4: Bring back the available-for-sale (AFS) category.

20. **Comment letters.** A few letters recommended that an available-for-sale category should be an alternative given the investment objectives of holding certain instruments and to minimise volatility in the income statement.

21. **Field tests.** Some field test entities suggested the option to take fair value gains and losses to equity should be available in Section 11, particularly where fair value has been determined based on quoted prices from relatively inactive markets or imprecise valuation techniques.
22. **WG recommendation.** Not discussed.
23. **Staff comment.** Under IAS 39, AFS instruments are non-derivative financial instruments that are not loans or receivables, not held-to-maturity investments (HTM), and not financial assets at fair value through profit or loss. Under IAS 39, an instrument that otherwise would meet the definition of HTM or FV through P&L (unless classified as held for trading) can optionally be designated to be AFS. Under IAS 39, AFS instruments are measured at fair value through equity, subject to impairment recognition in profit or loss.
24. **Staff recommendation.** Staff does not recommend adding an AFS category to the IFRS for SMEs. Under IAS 39, available-for-sale is a somewhat arbitrary category of financial assets – a default for financial assets that do not fit one of the three other categories. If AFS is added to the IFRS for SMEs, then rules for defining the other categories will also have to be added. The approach taken in Section 11 is to eliminate rules by classifying financial instruments according to their cash flow characteristics. This avoids the need to define such instruments as derivatives and embedded derivatives, held-to-maturity, and available-for-sale.
25. Although allowing instruments to be classified as AFS may reduce volatility in the income statement, it would actually lead to more complex accounting than accounting for those instruments at FV through P&L. This is because accounting for AFS instruments requires an entity to track changes in equity and also, if a loss occurs on an AFS instrument, to determine whether that loss should be recognised in profit or loss or as a reduction of equity. For that reason, staff does not recommend adding the AFS category to the IFRS for SMEs.

Question 11.4

Does the Board agree with the staff recommendation that the AFS category should not be added to Section 11?

Issue 11.5: Straight-line amortisation of discounts/premiums, not the effective interest method

26. **Comment letters.** Allow straight-line amortisation of discounts/premiums as an alternative to the effective interest method. This is a measurement simplification that maintains the basic principle of amortisation and often will not have a material effect.
27. **Field tests.** Several field test entities said that they had problems applying the effective interest method, for instance when measuring trade and other receivables. Many of these field test entities said that Appendix A is too complex. A few field test entities suggested practical examples are necessary.
28. **WG recommendation.** WG members did not support providing an accounting policy option for SMEs to use the straight-line method as an alternative to the effective interest method for amortising discounts and premiums. WG members generally acknowledged that the materiality principle in Section 2 would allow

SMEs to use the straight line method in some circumstances. WG members generally felt that the effective interest method would be easily understood if illustrated clearly with examples.

29. **Staff comment.** Appendix A to Section 11 provides guidance (though there are no numerical examples) for applying the effective interest method.
30. **Staff recommendation.** Straight-line amortisation should not be permitted as an accounting policy alternative to the effective interest method. However, guidance example(s) for applying the effective interest method should be included in the IFRS for SMEs. Also, currently Appendix A is taken word for word from the IAS 39 Application Guidance and has not been tailored to an SME context. Staff recommend rewriting and adding examples to Appendix A to explain any complex terminology and make the text more user-friendly. This would respond to the concerns raised by the field testers that Appendix A is too complex. Staff also note that while it may be true that straight-line amortisation ‘often will not have a material effect’, in most cases the only way to know for sure is to calculate or estimate the effective interest amounts and then compare them with the straight-line amounts.

Question 11.5

Does the Board agree with the staff recommendation that the ED should not be amended to permit straight-line amortisation of discounts and premiums as an alternative to the effective interest method and, instead, Appendix A should be rewritten, with examples added, to assist understanding?

Issue 11.6: Hedge accounting – shortcut method

31. **Comment letters.** Allow a shortcut method for hedging by which, if certain conditions are met, effectiveness could be presumed without a complex calculation. Such a method is described in paragraph BC75 of the ED.
32. **Field tests.** Very few field test entities performed hedge accounting, which is optional under 11.29. Some field test entities said the requirements are too complex for them, and other field test entities suggested requirements for hedge accounting should be removed altogether (particularly if the option to use IAS 39 in its entirety is retained). Of those field test entities applying hedge accounting, where details were given, hedging was predominately confined to interest rate hedges and cross-currency swaps.
33. **WG recommendation.** There was little support among WG members for providing a short-cut method of the type described in ED paragraph BC75.
34. **Staff comment.** In BC75, the Board explained why it did not adopt a shortcut method, as follows:

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

The Board concluded that simplified effectiveness testing is preferable to the shortcut method for two principal reasons:

- (a) Recognition of all hedge ineffectiveness in profit or loss is a basic principle of IAS 39. The shortcut method is inconsistent with that principle.
 - (b) To be able to assume that the possibility of hedge ineffectiveness is nil or insignificant, the key features of the hedging instrument and the hedged item, including the term, would have to match, and there could be no conditional terms. Consequently, hedge accounting would be prohibited if the hedging instrument is prepayable or puttable or has other early termination or extension features. Such a requirement would, in effect, make hedge accounting a practical impossibility for many, and perhaps most, SMEs.
35. **Staff recommendation.** Staff does not recommend allowing a short-cut method by which hedge effectiveness could be presumed for the reasons set out in BC 75 and also in light of the practical problems experienced from application of the method in the US, such as many entities applying the short-cut method when they should not have done and also entities being forced to buy derivatives to hedge marginal risks that are not otherwise normally hedged in order to qualify for the short-cut method.

Question 11.6

Does the Board agree with the staff recommendation that the ED should not be amended to allow a short-cut method for hedge accounting?

Issue 11.7: Clarify hedge accounting requirements, in particular regarding measurement of hedge effectiveness

36. **Comment letters.** Requirements for hedge accounting are unclear, in particular requirements for measuring hedge effectiveness should be within Section 11, not in the Basis for Conclusions.
37. **Field tests.** Some field test entities said the hedge accounting requirements are too complex for them. Field test entities reported problems understanding and applying the requirements for testing hedge effectiveness. Some field test entities suggested additional guidance is desirable. Some noted that use of external experts is not financially possible.
38. **WG recommendation.** WG members acknowledged that SMEs enter into hedging transactions and hence hedging must be addressed in IFRS for SMEs. WG members acknowledged that because hedge accounting is optional under Section 11, an SME could avoid the complexities of hedge accounting by simply accounting for the hedging instrument and hedged item as otherwise required in the IFRS for SMEs. WG members felt that the hedging part of Section 11 is not presented in a way that SMEs can readily understand. Each of the kinds of risks for which hedge accounting is permitted should be illustrated in an easy step-by-step presentation. This would include guidance for measuring hedge effectiveness.

39. **Staff comment:** There is limited discussion of measuring hedge effectiveness in ED paragraph BC74. Staff does not view this as substantive guidance on measuring hedge effectiveness.

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

40. **Staff recommendation.** Requirements for hedge accounting should be set out in a step-by-step presentation for each of the types of hedges identified in ED paragraph 11.31, to assist understanding. Specific requirements on measuring hedge effectiveness (including calculation example(s)) should be added to Section 11 and simplified in an SME context, if applicable.

Question 11.7

Does the Board agree with the staff recommendation that Section 11 should be amended to include step by step requirements for hedge accounting for each of the types of hedges identified in ED paragraph 11.31 and specific guidance on how to measure hedge effectiveness?

Issue 11.8: Simplify hedging documentation

41. **Comment letters.** Some respondents commented that the Board should simplify hedging documentation, though they did not make specific recommendations for change. Some respondents thought it was unclear what documentation is required, for example regarding the policy, hedging strategy, and objectives.
42. **Field tests.** No related comments.
43. **WG recommendation.** WG members felt that the requirements for hedging documentation in ED paragraph 11.30 are appropriate.
44. **Staff comment.** Here are the requirements of 11.30:
- 11.30 To qualify for hedge accounting, an entity shall comply with all of the following conditions:
- (a) the entity designates and documents the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified and the risk in the hedged item is the risk being hedged with the hedging instrument.
 - (b) the hedged risk is one of the risks specified in paragraph 11.31.
 - (c) the hedging instrument is as specified in paragraph 11.32.
 - (d) the entity expects the hedging instrument to be highly effective in offsetting the designated hedged risk. The effectiveness of a hedge is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

45. **Staff recommendation.** The documentation requirements in ED paragraph 11.30 are minimal – identify the risk being hedged, the hedged item, and the hedging instrument so it is clear that the risk in the hedged item is the risk being hedged with the hedging instrument. Staff does not recommend any change to the ED, except to split ED paragraph 11.30(a) into two separate bullet points so that ‘documentation’ is dealt with separately from ‘designation’ to make it clear exactly what needs to be documented.

Question 11.8

Does the Board agree with the staff recommendation that the hedging documentation requirement as proposed in ED paragraph 11.30 is appropriate?

Issue 11.9: Allow purchased options and debt instruments as hedging instruments

46. **Comment letters.** Several letters of comment recommended that the Board allow purchased options and debt instruments as hedging instruments. Such instruments would not qualify under ED paragraph 11.32 as drafted. Some respondents said it was common for SMEs have option-based hedging strategies using plain vanilla options and also to use debt instruments to hedge net investments.
47. **Field tests.** Very few field test entities performed hedge accounting, which is optional under ED paragraph 11.29. Of those field test entities applying hedge accounting, where details were given, hedging was predominately confined to interest rate or cross currency swaps.
48. **WG recommendation.** The WG considered a short presentation by one of the Board members explaining the rationale for not allowing purchased options and debt instruments as hedging instruments in IFRS for SMEs. The Board member noted that debt instruments are generally not allowed as hedging instruments under IAS 39 and have been excluded from use as hedging instruments under Section 11 mainly as an anti-abuse measure, since such hedging instruments allow entities to decide when to ‘turn on and off the switch’ in terms of recognising gains and losses in income. In the case of purchased options, these were not allowed as hedging instruments in Section 11 as it was considered that unless an entity is fairly sophisticated, it is unlikely to use purchased options due to the cost of the premium. The Board member said it was decided to focus only on ‘plain vanilla’ hedging instruments for simplicity. The main reason for allowing the fallback to full IAS 39 was to allow SMEs who have more sophisticated instruments and want to use sophisticated accounting to do so provided they comply with IAS 39 in full. WG members did not feel strongly that purchased options and debt instruments should be allowed as hedging instruments for SMEs.
49. **Staff comment.** Here are the requirements of ED paragraph 11.32:
- 11.32 This [draft] standard permits hedge accounting only if the hedging instrument has all of following terms and conditions:
- (a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 11.31 that is designated as being the hedged risk.

(b) it involves a party external to the reporting entity (ie external to the group, segment or individual entity being reported on).

(c) its **notional amount** is equal to the designated amount of the principal or notional amount of the hedged item.

(d) it has a specified maturity date not later than

(i) the maturity of the financial instrument being hedged,

(ii) the expected settlement of the commodity purchase commitment, or

(iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.

(e) it has no prepayment, early termination or extension features.

50. **Staff recommendation.** Staff recommend that purchased options and debt instruments should not be permitted as hedging instruments for the reasons outlined in paragraph 48 above.

Question 11.9

Does the Board agree with the staff recommendation that the ED should not be amended to permit purchased options and debt instruments as hedging instruments?

Issue 11.10: Allow hedge accounting for additional risks

51. **Comment letters.** Several letters suggested that the IFRS for SMEs should not limit the type of risks that can be hedged to four hedging strategies, as it is too restrictive. More discretion should be given to SMEs. Specific additional risks proposed in comment letters included:
- a. Price risk in equity shares
 - b. All interest rate risk
 - c. All foreign exchange risk
 - d. Combinations of interest rate and foreign exchange risk (hedged with a cross-currency swap)
 - e. Foreign exchange risk of a debt instrument measured at amortised cost
 - f. Commodity price risk
52. **Field tests.** Some field test entities said hedging should be allowed for types of risks in addition to those in ED paragraph 11.31. A few field test entities said they would be prevented from doing hedge accounting under the ED in circumstances where hedging was appropriate.
53. **WG recommendation.** WG members did not show any support for permitting hedge accounting for any additional risks other than those in paragraph 11.31. They felt that the risks listed in paragraph 11.31 are the ones SMEs typically hedge, and focussing on those risks makes hedge accounting under the SME standard relatively simple.
54. **Staff comment.** ED paragraph 11.31 states:

- 11.31 This [draft] standard permits hedge accounting only for:
- (a) interest rate risk of a debt instrument measured at amortised cost;
 - (b) foreign exchange or interest rate risk in a firm commitment or a highly probable forecast transaction;
 - (c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or
 - (d) foreign exchange risk in a net investment in a foreign operation.

55. **Staff recommendation.** With one qualification, staff agree with the WG that the risks listed in paragraph 11.31 are the ones SMEs typically hedge, and focussing on only those risks makes hedge accounting under the SME standard relatively simple. The one qualification relates to foreign exchange risk of a debt instrument measured at amortised cost. Staff acknowledge that SMEs often hedge this kind of risk. However, staff does not believe that this needs to be added to the list in paragraph 11.31 for the following reason: ED paragraph 11.10(a) states that normal accounts and notes payable would be measured at amortised cost because they typically satisfy the conditions in ED paragraph 11.9. This would include payables denominated in a foreign currency. However, any change in the payable because of a change in the exchange rate is recognised in profit or loss as required by ED paragraph 30.10 of Section 30 *Foreign Currency Translation*. Paragraph 30.10 states:

30.10 An entity shall recognise, in profit or loss in the period in which they arise, exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements, except as described in paragraph 30.13.

Since the effect of a change in the foreign currency of a financial instrument carried at amortised cost must be recognised in profit or loss, hedge accounting does not accomplish very much. Both the change in fair value of the hedging instrument (the cross-currency swap) and the change in the payable relating to the change in the exchange rate would be recognised in profit or loss and should offset each other except to the extent of the difference between the spot rate (at which the liability is measured) and the forward rate (at which the swap is measured). Therefore, staff do not recommend adding foreign exchange risk of a debt instrument measured at amortised cost to the list in 11.31.

Question 11.10

Does the Board agree with the staff recommendation that the list of risks eligible for hedge accounting in ED paragraph 11.31 should not be changed?

Issue 11.11: Clarify what is required for derivatives and embedded derivatives

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

57. **Field tests.** No related comment.
58. **WG recommendation.** There was some support for adding a definition of a derivative in order to make the requirements more explicit.
59. **Staff recommendation.** Guidance should be added to Section 11 on derivatives and embedded derivatives as many SMEs are familiar with the terms and hence the absence of any discussion may create confusion for entities that have them. In particular, SMEs may fail to identify this kind of financial instrument if there is no guidance. Staff do not recommend significantly changing the requirements in this area. For example, staff do not recommend adding a requirement that embedded derivatives should be bifurcated and accounted for separately, as this would be very onerous for SMEs and may not be applied properly. Instead, to enhance clarity, staff recommend stating explicitly what is required for derivatives based on what is currently stated implicitly under the ED, for example, stating that non-closely related embedded derivatives must be fair valued through profit or loss. Staff acknowledge that adding guidance in this area may mean having to define those terms.

Question 11.11

Does the Board agree with the staff recommendation that explicit requirements should be added to the IFRS for SMEs regarding derivatives and embedded derivatives?

Issue 11.12: Add specific requirements for factoring and similar transactions

60. **Comment letters.** Factoring of receivables and similar transactions are common for SMEs. Accounting for such transactions is not clear under Section 11. Add simplified requirements to clarify the proper accounting for such transactions when the factoring is (a) with recourse and (b) without recourse to the entity.
61. **Field tests.** More guidance, with examples, should be provided for factoring.
62. **WG recommendation.** Include typical examples of factoring.
63. **Staff recommendation.** Simplified requirements and/or examples should be added on accounting for factoring of receivables and similar transactions since they are commonly encountered by SMEs. The examples should illustrate factoring that is without recourse to the entity and also factoring where the financial institution or other funding source has recourse to the entity in case of non-payment of the receivables by the original customer. Some of the comments seemed to support a continuing involvement approach to derecognition similar to that in IAS 39, thereby permitting partial derecognition of financial assets and liabilities in some cases. Staff does not support a continuing involvement approach because the complexities would exceed the benefits.

Question 11.12

Does the Board agree with the staff recommendation that requirements and/or examples should be added to Section 11 on accounting for factoring and similar transactions?

Issue 11.13: Option to use IAS 39/IFRS 7 instead of Section 11

64. **Comment letters.** Do not allow the choice of using full IAS 39 *Financial Instruments: Recognition and Measurement*. Respondents who held this view generally were opposed to allowing any accounting policy options in the IFRS for SMEs. Also, some said that IAS 39 is too complex or too costly for SMEs to apply, and that allowing its use would reduce comparability among SMEs
65. **Field tests.** Several test entities actually chose the option to follow IAS 39 instead of Section 11. These tended to be entities that were already using full IFRSs under their national reporting requirements. Other field test entities said that it would be a burden to them to have to refer to full IFRSs and, so, they would drop all or most cross-references.
66. **WG recommendation.** WG members were divided on whether to retain the option to use IAS 39 as an alternative to Section 11.
67. **Staff comment.** The Board's reasons for allowing the choice of IAS 39/IFRS 7 in full are set out in paragraph BC78 as follows:

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

- (a) Although Section 11 is a simpler approach to accounting for financial instruments than IAS 39, some of the simplifications involve eliminating options that are available to companies with public accountability under IAS 39, for instance:
- (i) available-for-sale classification and the available-for-sale option;
 - (ii) held-to-maturity classification;
 - (iii) a continuing involvement approach to derecognition (ie partial derecognition); and
 - (iv) the use of hedge accounting for hedges other than the four specific types identified in paragraph BC73(c).

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

- (b) Because the proposed default category for financial instruments is fair value through profit and loss under the *IFRS for SMEs*, and cost or amortised cost is permitted only when specified conditions are met, some items measured at cost or amortised cost under IAS 39 because of their nature would be measured at fair value through profit or loss under the *IFRS for SMEs*. Some SMEs might find this added fair valuation burdensome.
- (c) Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. Those entities generally believe that the available-for-sale classification of IAS 39 is appropriate to account for strategic investments. Under the draft *IFRS for SMEs*, however, these strategic investments would be accounted for at fair value through profit or loss.

- (d) The derecognition provisions of the draft *IFRS for SMEs* would not result in derecognition for many securitisations and factoring transactions that SMEs may enter into, whereas IAS 39 would result in derecognition.
68. **Staff recommendation.** At the May 2008 Board meeting, the Board decided that the final Standard should be fully stand-alone (Issue G1 in Agenda Paper 9A for that meeting) and that, in general, the accounting policy options in full IFRSs should be available to SMEs (Issue G2 in Agenda Paper 9A). Those decisions were consistent with the view expressed in the great majority of comment letters, by field test participants, and by the Working Group (though the one area where the WG and many respondents were divided was whether to retain the option to use IAS 39 as an alternative to Section 11).
69. Staff recommend that the option to follow IAS 39 in full (and IFRS 7) instead of following Section 11 be deleted. An SME that has complex financial instruments always has the option to follow full IFRSs rather than the IFRS for SMEs. If an SME is capable of applying IAS 39 (and IFRS 7) properly, the SME should also be capable of applying full IFRSs properly. Many SMEs would find IAS 39 too onerous and would be unable to apply it correctly, leading to a possible reduction in quality of financial information. Therefore this should not be an accounting policy option available to SMEs. In addition, allowing IAS 39 would cause an inconsistency in approach between classification of debt and equity, and the measurement of financial instruments, since the ED adopts a more simplified approach to classification of debt and equity under Section 21. If IAS 39 were to be incorporated into the stand-alone IFRS for SMEs it would approximately double the length of the document, even if some simplification was possible in an SME context. This would make the document less user-friendly and appear more complex.

Question 11.13

Does the Board agree with the staff recommendation that the ED should be amended to remove the option for SMEs to follow IAS 39 in full (and IFRS 7) instead of following Section 11?

Issue 11.14: Impairment of an instrument carried at amortised cost

70. **Comment letters.** This issue is described in the next paragraph, because it was raised by field test entities, not comment letters on the ED.
71. **Field tests.** A small number of field test entities had difficulties with the requirements for recognising impairment of instruments measured at cost or amortised cost in Section 11. They raised two different issues:
- a. The first issue relates to determining the present value of estimated cash flows discounted at the financial asset's original effective interest rate under ED paragraph 11.22(a). Some field test entities said this calculation is burdensome for SMEs. Others said that the resulting present value measurement is meaningless because it is neither cost nor fair value.

- b. The second issue is that the impairment test in ED paragraph 11.22(b) for equity instruments carried at cost contradicts their classification under ED paragraph 11.7(c) (“fair value cannot otherwise be measured reliably”).
72. **WG recommendation.** Regarding the first field test issue, WG members felt the requirement in ED paragraph 11.22(a) for measuring the impairment of an instrument (such as a receivable or loan) that the entity designates at initial recognition to be measured at amortised cost results in departing from cost to a figure that is meaningless because the discount rate is the loan’s original effective interest rate, not a current rate. Nonetheless, WG members acknowledged that impairment could not be ignored, and the only alternative is to write the asset down to fair value through profit or loss instead.
73. Regarding the second field test issue, WG members acknowledged the apparent contradiction of measuring impairment of such an instrument by reference to fair value. Still, most WG member felt that the approach in 11.22(b) is the only possible alternative. In circumstances where it is clear the asset is impaired, it is appropriate to try to approximate the fair value of these assets. Hence most WG members felt the approach should not be changed, although 11.22(b) would benefit from a clearer explanation of the rationale.
74. **Staff comment.** Here are the requirements of ED paragraph 11.22 (and 11.7, to which 11.22 refers) of the ED:
- 11.22 An entity shall measure an impairment loss as follows:
- (a) for an instrument measured at amortised cost less impairment in accordance with paragraph 11.7(a), the impairment loss is the difference between the asset’s carrying amount and the present value of estimated cash flows discounted at the financial asset’s original effective interest rate; and
 - (b) for an instrument measured at cost less impairment in accordance with paragraph 11.7(b) and (c), the impairment loss is the difference between the asset’s carrying amount and the asset’s fair value.
- 11.7 At each reporting date, an entity shall measure the following financial instruments at cost or amortised cost less impairment, as indicated:
- (a) an instrument (such as a receivable, payable, or loan) that meets the conditions of paragraph 11.9, and that the entity designates at initial recognition to be measured at amortised cost (using the effective interest method) less impairment. Appendix A to this section provides guidance on applying the effective interest method.
 - (b) a commitment to make or receive a loan that:
 - (i) cannot be settled net in cash,
 - (ii) when executed, is expected to meet the conditions for recognition at cost or amortised cost less impairment, and
 - (iii) the entity designates at initial recognition to be measured at cost less impairment.

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

75. Staff recommendation.

- a. Regarding measurement of an impairment loss for a financial asset (such as a receivable or a loan) that is carried at amortised cost (ED paragraph 11.22(a)), staff agree with those who say that discounting at the loan's original effective interest rate produces a measure that is not meaningful. The purpose of the impairment calculation is to ensure that the asset is not carried in the balance sheet at more than its recoverable amount. Recoverable amount should be a measure of the asset's current value. Discounting at the original effective interest rate doesn't achieve that. Therefore, staff recommends, in ED paragraph 11.22(a), that the impairment loss be the difference between the asset's carrying amount and the present value of the current estimate of the amounts and timing of cash flows that the entity expects to receive from the asset (both principal and interest), discounted at the current market rate of interest for a loan of similar risk and terms.
- b. Regarding measurement of an impairment loss for an equity instrument carried at cost because its fair value cannot otherwise be measured reliably, staff acknowledges the anomaly of requiring a write-down to the asset's fair value when impairment is indicated. At the same time, staff believe that the indication of impairment cannot simply be ignored. Continuing to carry an asset at cost when that asset is impaired does not faithfully represent the underlying circumstances. Staff recommend, in ED paragraph 11.22(b), that the impairment loss be the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation that is not subject to the same level of reliability as would normally be expected) of the amount (which might be zero) that the entity would receive for the asset if it were to be sold.

Question 11.14A

Does the Board agree with the staff recommendation that the requirement in ED paragraph 11.22(a) be amended so that the impairment loss for a financial asset carried at amortised cost is the difference between the asset's carrying amount and the present value of the current estimate of the amounts and timing of cash flows that the entity expects to receive from the asset (both principal and interest), discounted at the current market rate of interest for a loan of similar risk and terms?

Question 11.14B

Does the Board agree with the staff recommendation that the requirement in ED paragraph 11.22(b) be amended to state that an impairment loss for an equity instrument carried at cost because it is not publicly traded and its fair value cannot otherwise be measured reliably should be the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation of below-normal reliability) of the amount (which might be zero) that the entity would receive for the asset if it were to be sold?

Issue 11.15: Clarify accounting for interest rate swaps

76. **Additional staff issue.** It is understood that the Board's intent is that all derivatives should be measured at fair value through profit or loss (except for those that are hedging instruments that qualify under ED paragraph 11.37 for recognition of the change in fair value directly in equity). However, it seems that interest rate swaps may meet the test in ED paragraph 11.9 for measurement at amortised cost because:
- a. Paragraph 11.9(b) allows returns to be at a fixed rate or a variable tied to an observable interest rate. An interest rate swap would meet this test because it has a fixed rate and variable rate.
 - b. Paragraph 11.9(c) says "There is no contractual provision that could result in the holder losing the principal amount and any interest attributable to the current period or prior periods." Because swaps have no principal amount they would seem to meet the test in paragraph 11.9(c).
- 11.9(c) should be rewritten to clarify that swaps must be measured at fair value through profit or loss.
77. **Comment letters.** No related comments.
78. **Field tests.** No related comments.
79. **WG recommendation.** Not discussed.
80. **Staff recommendation.** Paragraph 11.9(c) should be reworded as follows:
- "There is no contractual provision that could result in the holder incurring a loss of the principal amount and any interest attributable to the current period or prior periods or from cash settlement".

Question 11.15

Does the Board agree with the staff recommendation that ED paragraph 11.9(c) should be reworded as suggested in paragraph 80 directly above?

Section 12 Inventories

Issue 12.1: Inventories – use most recent purchase prices

81. **Comment letters.** Allow SMEs to measure all of their inventory at the most recent purchase prices.
82. **Field tests.** No related comments.
83. **WG recommendation.** WG members did not support allowing SMEs to measure all of their inventory at the most recent purchase prices or most recent costs.
84. **Staff comment.** ED paragraph 12.15 already states:
- 12.15 An entity may use techniques such as the standard cost method or the retail method for measuring the cost of inventories if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions. The retail method measures cost by reducing the sales value of the inventory by the appropriate percentage gross margin.
85. **Staff recommendation.** Paragraph 12.15 is intended to explain to an SME that it may use a simplified technique for measuring the cost of inventories if the results approximate cost. The burden is on the SME to assess whether the technique approximates cost. Using the most recent purchase price is another kind of simplification for approximating cost where prices are stable or turnover is rapid. Staff recommend that it be added to the two other methods already identified in 12.15, with the same qualifier as in 12.15 – ‘if the results approximate cost’.

Question 12.1

Does the Board agree with the staff recommendation that the technique of measuring inventory at the most recent prices if the results approximate cost should be added to the other two methods of approximation already identified in ED paragraph 12.15?

Issue 12.2: Inventories – allow LIFO

86. **Comment letters.** Allow LIFO as an inventory costing method.
87. **Field tests.** No related comments.
88. **WG recommendation.** WG members did not support allowing the LIFO method.
89. **Staff recommendation.** Some would allow an SME to use LIFO only if their jurisdiction allows it for tax purposes. Others would permit SMEs to use it more broadly. LIFO is prohibited under full IFRSs, a conclusion that the Board debated at length when revising IAS 2 *Inventories* in 2003. LIFO is used in only a few jurisdictions around the world, and usually its use is optional in those jurisdictions. The balance sheet distortion that results from LIFO is well recognised by accountants, but probably much less so by users of SME financial statements. Staff recommend that SMEs should not be permitted to use LIFO. Staff note that if prices are stable, LIFO may lead to a representative measure of cost (as would using recent prices). In Issue 12.1, staff propose an entity may use a yet more simplified technique than LIFO, such as using recent purchase prices, if the results approximate cost.

Question 12.2

Does the Board agree with the staff recommendation that the ED should not be amended to permit SMEs to use LIFO even if it is permitted locally for tax purposes?

Issue 12.3: Simplify allocation of fixed and variable production overheads to inventories

90. **Comment letters.** Simplify the requirements for allocating production overheads to inventories in ED paragraphs 12.7 and 12.8 – particularly the requirements in ED paragraph 12.8 for allocating fixed production overheads. Or do not require allocation of production overheads at all, that is, allow SMEs to use a direct costing model.
91. **Field tests.** Several field test entities had problems applying the full cost approach. Some field test entities feel it is administratively onerous to measure indirect production costs and they noted that their reporting systems cannot handle such costs. Other field test entities said it was difficult to determine how to allocate costs, for example allocation of transportation costs and costs not directly attributable to one product. Some field test entities said they agree with the concept in general, but, since application is difficult, more guidance is needed on how to determine which costs to include in inventories.
92. **WG recommendation.** Not discussed.
93. **Staff comment.** 12.4, 12.7, and 12.8 state:
- 12.4 An entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Costs of conversion

- 12.7 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Allocation of fixed production overheads

- 12.8 An entity shall allocate fixed production overheads to the costs of conversion based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are

incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

94. **Staff recommendation.** Staff do not believe that either ED paragraph 12.7 or 12.8 is onerous for an SME. ‘Systematic allocation’ is a principle, not a detailed rule. The fundamental issue is whether the principle in ED paragraph 12.4 is appropriate for SMEs, that is, whether the cost of inventories should include all costs of conversion including production overheads. The cost of an asset, in general, includes its purchase price and all other costs necessary to make it ready for use by the entity. Production overhead is an essential cost of producing inventory. Therefore, production overhead should be included in the cost of inventory. In all likelihood, an SME will already keep track of the full costs of inventory for pricing, income taxes, and other purposes, so allocation of production overhead will generally not add to administrative burden. A ‘direct costing’ approach, which includes only materials and labour cost, is not appropriate because neither the balance sheet nor the income statement is ‘representationally faithful’. Staff does not recommend any change to ED paragraphs 12.4, 12.7, or 12.8.

Question 12.3

Does the Board agree with the staff recommendation that fixed and variable production overhead should be included in the cost of inventory and, therefore, that ED paragraphs 12.4, 12.7, and 12.8 should not be changed?

Issue 12.4: Do not include non-production overheads in inventories

95. **Comment letters.** Do not require non-production overheads in inventories. ED 12.10 says ‘it may be appropriate’ to include non-production overheads.
96. **Field tests.** No related comments.
97. **WG recommendation.** WG members generally felt that the language used in 12.10 (‘it may be appropriate’) regarding inclusion of non-production overheads in inventory cost should remain.
98. **Staff comment.** 12.4 and 12.10 state:
- 12.4 An entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
- 12.10 An entity shall include other costs in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include, in the cost of inventories, non-production overheads or the costs of designing products for specific customers. If an entity chooses to capitalise borrowing costs as provided by paragraph 24.2(b), IAS 23 *Borrowing Costs* identifies limited circumstances when borrowing costs are included in the cost of inventories.

99. **Staff recommendation.** Staff acknowledge that saying “it may be appropriate to include non-production overheads in the cost of inventories” in ED paragraph 12.10 is taken from IAS 2.15. Those who support keeping it in the IFRS for SMEs point out that it is an elaboration on the opening sentence of 12.10 – the principle being inclusion of all costs needed to bring the inventories to their present location and condition. Still, staff note that non-production overheads is a very broad but undefined term, and saying ‘it may be appropriate’ is not helpful guidance for an SME. Staff recommend deletion of the second sentence of paragraph 12.10. The principle is set out clearly in the first sentence of 12.10.

Question 12.4

Does the Board agree with the staff recommendation to delete the second sentence of ED paragraph 12.10, but leave the first sentence plus the final sentence on borrowing costs?

Issue 12.5: Replace Section 12 with IAS 2 in full

100. **Comment letters.** Replace Section 12 with IAS 2 in full, as IAS 2 is short and easy to apply.
101. **Field tests.** No related comments.
102. **WG recommendation.** Not discussed.
103. **Staff comment:** Only the following paragraphs from IAS 2 concerning recognition and measurement of inventories are not in the IFRS for SMEs:
- IAS 2.8, which elaborates on what are inventories.
 - IAS 2.24, which is guidance on specific identification of costs.
 - Paragraphs IAS 2.26 and IAS 2.27, which are guidance on applying cost formulas.
 - IAS 2.28 to IAS 2.33 on net realisable value. This issue is included in Section 26, which deals comprehensively with impairment of non-financial assets.

Otherwise, all of the recognition and measurement section of IAS 2 is included.

104. **Staff recommendation.** Staff recommend that Section 12 not be replaced by IAS 2 in full. However, staff will consider the paragraphs above individually when considering whether additional guidance is necessary in the final Standard. Staff has developed a list of all requests for additional guidance and is developing recommendations about whether and how such guidance should be provided. Staff plans to bring recommendations about guidance to the Board at a future Board meeting.

Question 12.5

Does the Board agree with the staff recommendation that IAS 2 should not be used in place of Section 12?

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)

105. **Comment letters.** The most frequent comment relating to these two sections is that the proposed IFRS for SMEs 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 method 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 SMEs – presumably requiring that such investments be treated as financial instruments under Section 11 *Financial Assets and Financial Liabilities*.
106. **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 SMEs. A few entities agree with allowing different options, but they feel all options should be fully explained in the IFRS for SMEs rather than cross-referenced to IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.
107. **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 SMEs. WG members favoured adding a description of the cost method to the IFRS for SMEs 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.
108. **Staff comment:** Items (a) through (g) in paragraph 105 above all relate to the method(s) of accounting for associates and jointly controlled entities that

respondents think should be available to SMEs. Under the ED, cost, equity method, and fair value through profit or loss are all options for associates. Those three plus proportionate consolidation are all options for jointly controlled entities. An SME would be required to adopt a single method for all associates and a single method for all jointly controlled entities.

109. The SME ED 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.
110. **Staff recommendation.** Staff recommend retaining the cost method as it is expected most SMEs will use this method and it is an appropriate simplification, without significant loss of information for users. Some SMEs 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 SMEs to change their accounting on adoption of the IFRS for SMEs for the first time and then potentially again at the first update of the IFRS for SMEs. Further, at the May 2008 meeting, the Board decided that, in general, the accounting policy options in full IFRSs should be available to private entities (General Issue G2 of Agenda Paper 9A). Any changes should first be made with respect to full IFRSs and then considered in an SME context.

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)

111. **Comment letters.** Allow SMEs 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.
112. **Field tests.** No related comments.
113. **WG recommendation.** Not discussed.
114. **Staff comment.** Currently under IAS 28 (since the equity method is applied 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.
115. **Staff recommendation.** Staff do not believe that the three-month requirement is a hardship for SMEs since the equity method and proportionate consolidation are optional. SMEs 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 SMEs 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

116. **Comment letters.** Allow the fair value model, but changes in fair value should go to equity. Some letters stated the proposal differently: The IFRS for SMEs should allow the IAS 16 *Property, Plant and Equipment* revaluation model for investment property.
117. **Field tests.** No related comments.
118. **WG recommendation.** There was no support amongst WG members for a fair-value-through-equity model.
119. **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 SMEs.

Question 15.1

Do Board members agree with the staff recommendation that the ED should not be amended to give SMEs the option to recognise changes in fair value of investment property directly in equity?

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

120. **Comment letters.** Do not allow the option to use the fair value model for reasons of complexity and lack of comparability.
121. **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.
122. **WG recommendation.** Members of the WG supported keeping both accounting policy options as proposed in the ED. Because the ED allows the fair value through profit or loss model by cross-reference, if cross-references are eliminated then this will mean that an explanation of that model must be included in the IFRS for SMEs.
123. **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 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). An entity using the cost model can elect to disclose fair values in the notes. Further, allowing both the cost-depreciation-impairment model and the fair value through profit or loss model as an 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. Therefore, for all of these reasons, staff do not recommend allowing only the cost-depreciation-impairment model and prohibiting the fair value model.

Question 15.2

Do Board members agree with the staff recommendation that, as proposed in the ED, the IFRS for SMEs 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

124. **Comment letters.** Remove the option in ED paragraph 15.2 to classify property held under an operating lease as investment property.
125. **Field tests.** Classifying leasehold property as investment property causes problems.
126. **WG recommendation.** WG members supported retaining the option to classify property held under an operating lease as investment property.
127. **Staff comment.** This is an issue only if SMEs 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*. If the Board agrees with the staff's recommendation in Issue 15.2 to allow both models as accounting policy options, as proposed in the ED, the option for an SME to classify property held under an operating lease as investment property should be retained. 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 SMEs. An entity not choosing the option would account for any up-front payment made under such a lease as a prepayment.
128. **Staff recommendation.** Staff recommend retaining the option in ED paragraph 15.2 to classify property held under an operating lease as investment property.

Question 15.3

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

129. **Comment letters.** No related comments. This was an additional issue noted from field testing.
130. **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.
131. **WG recommendation.** Not discussed.
132. **Staff comment.** This is an issue only if SMEs 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.)
133. **Staff recommendation.** An SME owning mixed-use property that feels the separation is burdensome can choose to account for its investment property under Section 16 of the ED, 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 an SME 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 currently proposed in the ED?

Section 16 Property, Plant and Equipment

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

134. **Comment letters.** Do not require component depreciation for SMEs, or make clear that it is optional.
135. **Field tests.** Component depreciation is not relevant and would cause problems if applied strictly.
136. **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.
137. **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.

138. **Staff recommendation.** Depreciation is the systematic allocation of the cost 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 should choose a depreciation method for an asset that reflects the pattern of consumption of benefits. Component depreciation is consistent with that principle if significant parts of a single asset have significantly different patterns of benefit. At the same time, for most depreciable assets owned by SMEs, 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 16.14 but rewriting 16.14 to make application easier for an SME by addressing the normal case first, as follows:

16.14 If all of the significant parts of an item of property, plant and equipment 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

139. **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.

140. **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's questionable whether continual remeasurement has benefits in the financial statements of small 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.
141. **WG recommendation.** While some WG members found this requirement to be burdensome for an SME, the majority view was not to make any change to the proposal as SMEs would normally be monitoring this type of information as part of good business practice.
142. **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 SMEs might have different policies for maintaining and/or disposing of identical assets. One SME might do no maintenance on its vehicles because it keeps them only two years before disposal, while another SME 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 SMEs 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 SMEs with guidance to ensure the requirement is understood and applied correctly.

Question 16.2

Does the Board agree with the staff recommendation that an SME 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]

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

144. **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.
145. **WG recommendation.** WG members would retain this option and other accounting policy options from full IFRSs.
146. **Staff comment.** Whether all accounting policy options available in full IFRSs should be available to SMEs was one of the general issues (G2) in Agenda Paper 9A for the May 2008 Board meeting. At that meeting, the Board decided that, in general, the accounting policy options in full IFRSs should be available to private entities. Moreover, revaluation of property, plant and equipment has tended to be a common and longstanding practice, even for SMEs, in some jurisdictions.
147. **Staff recommendation.** Given the Board's decision on General Issue G2, staff recommends that SMEs 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 SMEs 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

148. **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*.
149. **Field tests.** No related comments.
150. **WG recommendation.** Not discussed.
151. **Staff recommendation.** Those who support this proposal say separation may require a costly valuation. Staff believe that an SME 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 SMEs. Staff recommend no change to the ED.

Question 16.4

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

152. **Comment letters.** No related comments. This was an additional issue noted from field testing.
153. **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.
154. **WG recommendation.** Not discussed.
155. **Staff recommendation.** Staff believe that this matter should be addressed by additional guidance rather than by changing ED paragraph 16.3.

Question 16.5

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]

156. **Comment letters.** SMEs 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.
157. **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.
158. **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.
159. **Staff recommendation.** Staff recommend that all intangible assets of SMEs 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 SMEs are unlikely to be able to estimate accurately the length of a longer finite life.
160. Staff make this recommendation for several reasons. First, SMEs are unlikely to have intangibles other than goodwill with indefinite lives. Second, 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. Third, from a practical standpoint many smaller entities would find it difficult to assess impairment as accurately and on such a timely basis as larger

entities, meaning the information could be less reliable. Staff support amortisation as an appropriate simplification for SMEs as it reduces the likelihood of impairment testing over time. Staff believe that impairment testing is a burden for SMEs. Staff's recommendation for amortisation – particularly if coupled with a relative 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 SMEs, 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]

161. **Comment letters.** Some comment letters said capitalisation of development costs should not be allowed. Others said the capitalisation model should be required.
162. **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.
163. **WG recommendation.** WG members supported the proposal to give SMEs the option (which is not in full IFRSs) to expense all development costs for simplicity.
164. **Staff comment.** Whether all accounting policy options available in full IFRSs should be available to SMEs was one of the general issues (G2) in Agenda Paper 9A for the May 2008 Board meeting. At that meeting, the Board decided that, in general, the accounting policy options in full IFRSs should be available to private entities.
165. **Staff recommendation.** Staff recommend that SMEs should be allowed to expense all development costs. Staff make this recommendation because many SMEs do not have the resources to assess commercial viability on a timely and ongoing basis, and users of SME 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 SME financial statements. Given the Board's decision on General Issue G2, staff recommends that SMEs should not be prohibited from using the capitalisation model for development costs. Therefore, staff recommend that SMEs 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, SMEs 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

166. **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.
167. **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.
168. **WG recommendation.** WG members favoured retaining the requirement as proposed in the ED.
169. **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.

Question 17.3

Does the Board agree with the staff recommendation that an SME 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]

170. **Comment letters.** Do not allow SMEs to revalue any intangibles, that is, remove the option. Few SMEs will have intangible assets eligible for revaluation and, of those SMEs 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 an SME chooses to provide these.
171. **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.
172. **WG recommendation.** WG members would retain this option and other accounting policy options from full IFRSs.
173. **Staff comment.** Whether all accounting policy options available in full IFRSs should be available to SMEs is one of the general issues (G2) in Agenda Paper 9A for the May 2008 Board meeting. At that meeting, the Board decided that, in

general, the accounting policy options in full IFRSs should be available to private entities.

174. **Staff recommendation.** Given the Board's decision on General Issue G2, staff recommends that SMEs should not be prohibited from using the revaluation model for their qualifying intangible assets.

Question 17.4

Does the Board agree with the staff recommendation to allow SMEs 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]

175. **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).
176. **Field tests.** The removal of amortisation for goodwill would cause problems as it would generally be very subjective or even impossible to carry out an impairment review. It is also difficult to identify impairment indicators.
177. **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 SMEs 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 SMEs 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 SMEs.
178. **Staff comment:** Allowing or requiring amortisation of goodwill and other indefinite-life intangibles was proposed in many of the comment letters and by some of the field test participants. Here is the Board's reasoning (from Basis for Conclusions) for not having an amortisation approach:

Goodwill impairment

BC79 In their responses to the recognition and measurement questionnaire and at the round-table meetings, many preparers and auditors of SMEs' financial

statements said that the requirement in IFRS 3 *Business Combinations* for an annual calculation of the recoverable amount of goodwill is onerous for SMEs because of the expertise and cost involved. They proposed, as an alternative, that SMEs should be required to calculate the recoverable amount of goodwill only if impairment is indicated. They proposed, further, that the IFRS for SMEs should include a list of indicators of impairment of goodwill as guidance for SMEs. The Board agreed with those proposals. The draft IFRS for SMEs proposes an indicator approach and includes a list of indicators based on both internal and external sources of information.

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

- (a) An amortisation approach still requires assessment of impairment, so it is actually a more complex approach than an indicator-triggered assessment of impairment.
- (b) Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset over its useful life. By its nature, goodwill often has an indefinite life. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not faithfully represent economic reality.
- (c) When the IASB was developing IFRS 3, and related amendments to IAS 38 *Intangible Assets*, most users of financial statements said they found little, if any, information content in the amortisation of goodwill over an arbitrary period of years.

179. **Staff recommendation.** Based on the reasons explained in Issue 17.1 and provided by WG members in paragraph 177, staff recommend that goodwill (and all other intangible assets) of SMEs 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 SMEs 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 relative short maximum amortisation period when useful life cannot be assessed – would reduce the circumstances in which an impairment test would be triggered. Also, from a practical standpoint many smaller entities would find it difficult to assess impairment as accurately and on such a timely basis as larger 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 SME 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.

Question 18.1A

Does the Board agree with the staff recommendation that Section 18 should be amended to require that goodwill of SMEs 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

180. **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).
181. **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 SMEs, entities are unlikely to look for such assets.
182. **WG recommendation.** WG members would continue to require separation of intangibles as proposed in ED paragraphs 17.6 and 18.14(c).
183. **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 an SME 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, SMEs 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 an SME 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

184. **Comment letters.** Do not require recognition of contingent liabilities.
185. **Field tests.** No related comments.
186. **WG recommendation.** WG members supported the proposal in the ED to require recognition of contingent liabilities acquired in a business combination.
187. **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 an SME if coupled with a 'without undue cost or effort' condition to the fair value measurement requirement. In particular, SMEs 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 an SME 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

188. **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.
189. **Field tests.** No related comments.
190. **WG recommendation.** Not discussed.
191. **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 SMEs 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

192. **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'.
193. **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 SMEs material relief, particularly regarding the disclosure requirements.

194. **WG recommendation.** WG members did not support allowing SMEs to follow merger accounting for any business combinations other than combinations of entities under common control.
195. **Staff recommendation.** Staff do not recommend allowing SMEs 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). SMEs 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, much of which should be available from discussions when setting the price. 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 SMEs 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

196. **Comment letters.** Do not require the straight-line method for operating leases (spreading total lease payments evenly over the lease term).
197. **Field tests.** No related comments.
198. **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.
199. **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.
200. **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]

201. **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.
202. **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.
203. **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 SMEs will have difficulty in understanding that term and in applying it consistently. Instead, they recommend that the IFRS for SMEs 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.
204. **Staff comment.** In Issue G13 of Agenda Paper 9A for 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’. 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.
205. **Staff recommendation.** As noted in Issue G13 of Agenda Paper 9A, 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 an impact 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]

206. **Comment letters.** Simplify classification criteria, for example, use fewer criteria or introduce quantitative tests. Several letters suggested treating all leases as operating leases.
207. **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.
208. **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 SMEs. The majority, however, did not feel strongly for or against this proposal.
209. **Staff recommendation.** Staff do not recommend that all leases be accounted for as operating leases for the reasons set out in ED paragraph BC97. 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 an SME. 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 an SME might have interpreted ‘major part’. Staff believes this change is an appropriate clarification and simplification in an SME 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

210. **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.
211. **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 SMEs to capitalise more leasehold land.
212. **WG recommendation.** WG members felt that the requirements can be left as proposed in the ED.
213. **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 SMEs 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 SMEs in Issue 15.2. 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*.
214. **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

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

216. **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.
217. **WG recommendation.** WG members did not recommend any simplification of Section 20.
218. **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 SME 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

219. **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 scope of the IFRS for SMEs. 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).
220. **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 SMEs (although these were still in exposure draft stage at the time the field testing was performed).

221. **WG recommendation.** Members of the WG recommended adopting in the IFRS for SMEs 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.
222. **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 are subordinate to all other classes of instruments and that entitle the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.
 - 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.
223. **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]

224. **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 SMEs 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 SMEs 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.
225. **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.
226. **WG recommendation.** Not discussed.
227. **Staff recommendation.** Staff recommend eliminating the requirement 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 SMEs. In particular, for a small entity, it would be difficult to determine what would have been the interest rate if the debt had no embedded equity feature for a non-listed company. Also, this ‘imputation’ is not likely to be understood by users of SME 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.

228. 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, the two different instruments should be accounted for separately.

Question 21.2

Does the Board agree with the staff recommendation that the ED should be amended to prohibit split accounting by SMEs and instead the entire 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?

Section 22 Revenue

Issue 22.1: Revenue – percentage of completion

229. **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.
230. **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.
231. **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 SMEs. They also recommended providing additional examples to illustrate percentage-of-completion calculations and presentation.
232. **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 BC 99 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 the completed contract method can produce a potentially misleading accounting result for the contractor, with some years of large profits and other years of large losses. 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. Also users of financial statements have told the Board that, for a 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. SMEs 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, but recommendation is unchanged]

- 233. **Comment letters.** Several comment letters suggested that only the IFRS for SMEs model for government grants in 23.3(a) should be allowed as it was simpler and produced better information. A similar number of comment letters suggested only the IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* requirements should be allowed to maintain consistency with full IFRSs and because some felt the IFRS for SMEs model was unclear.
- 234. **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.
- 235. **WG recommendation.** Not discussed.
- 236. **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.
237. 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 SME has adopted the fair value model as its accounting policy.
238. **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. In Issue G2 (Agenda Paper 9A for the May 2008 Board meeting), staff provided their detailed reasoning for removing the more complex accounting options in the IFRS for SMEs and, hence, retaining only the simpler options for SMEs, where possible. At that meeting, the Board decided that, in general, all accounting policy options in full IFRSs should be available to SMEs. 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 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 an SME 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. In Issue G13 of Agenda Paper 9A for the May 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'. 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. 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 in Section 23 and that the option to follow IAS 20 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]

239. **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.
240. **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.
241. **WG recommendation.** WG members supported giving SMEs the option to expense all borrowing costs since expensing is the simpler approach. But they would also allow capitalisation as an accounting policy option.
242. **Staff recommendation.** In Issue G2 in Agenda Paper 9A for the May 2008 Board meeting, staff provided their detailed reasoning for removing the complex accounting policy options and, hence, retaining only the simpler options for SMEs, where possible. At that meeting, the Board decided that, in general, all accounting policy options in full IFRSs should be available to private entities. Staff therefore recommend that private entities should have an accounting policy choice of 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 by smaller 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 is proposed in the ED?

Issue 24.2: Borrowing costs – simplification of capitalisation model

243. **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).
244. **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.
245. **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.
246. **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, SMEs 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]

247. **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 issuance (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.
248. **Field tests.** Few field test entities had share-based payment transactions. Two had equity-settled share-based payment transactions, and they commented that they were unable to measure fair values of either the shares or the share options. A few entities that did not have any share-based payment transactions commented that they would have found Section 25 difficult had they needed to apply it.
249. **WG recommendation.** Most WG members felt that the intrinsic value method in IFRS 2 *Share-based Payment* is not much of a simplification for SMEs 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.

250. **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.
251. Staff feels this method of substituting historical volatility of an appropriate industry sector index for expected volatility is consistent with what is already required in IFRS 2, as indicated by BC139-140 of IFRS 2:

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.

252. **Staff recommendation.** Staff does not recommend a disclosure only approach for equity-settled share-based payments for the reasons given in BC 101 of the SME ED. Staff feel if conceptual arguments made against recognition of an expense in relation to employee share options are valid (e.g., that there is no cost to the entity), those arguments ought to apply equally to transactions involving other equity instruments (e.g., shares) and to equity instruments issued to other parties (e.g., suppliers of professional services).
- 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.
253. 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.
254. Staff acknowledge that the intrinsic value method does not provide much of a simplification and could be seen as more burdensome than determining the fair value of equity-settled share-based payments, 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, often substantial in amount.
255. **PROPOSAL FOR MEASURING EQUITY-SETTLED SBPs STILL TO BE DEVELOPED.** Staff believe that the IFRS 2 approach for measuring equity-settled share-based payments, 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 SMEs. 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.
256. Regarding group arrangements, staff recommend 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. 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 SMEs 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 SMEs 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]

257. **Comment letters.** Allow or require consideration of value in use or a simplified value-in-use calculation that uses information easily available to a small entity - for example 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.
258. **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.
259. **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 SMEs. 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.
260. **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.
261. **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 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 SME intends to sell the asset, but there is no binding sale agreement, recoverable amount would usually be the expected market price less the 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 SME 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).
262. 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 in cases where the market value of machinery/vehicles 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 SMEs 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 (description of the basis of measurement) from Agenda Paper 9A from the May 2008 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]

- 263. **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.
- 264. **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 SMEs should have the option to amortise goodwill.
- 265. **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 SMEs, WG members did not propose any specific simplifications.
- 266. **Staff comment:** The IFRS for SMEs requires an SME to determine whether there is an indicator that goodwill is impaired (ED paragraphs 26.20–21). If impairment is indicated, then apply ED paragraph 26.22:
 - 26.22 If there is an indication that goodwill has been impaired the entity shall follow a two-step process to determine whether to recognise an impairment loss:

Step 1:

- (a) allocate the goodwill to the component(s) of the entity that benefit from the goodwill (generally the lowest level within the entity at which the goodwill is monitored for internal management purposes);
- (b) measure the fair value of each component in its entirety, including the goodwill;
- (c) compare the fair value of the component with the carrying amount of the component;
- (d) if the fair value of the component equals or exceeds its carrying amount, neither the component nor the goodwill is impaired; if the fair value of the component is less than its carrying amount, the difference is an impairment loss that shall be recognised in accordance with Step 2.

Step 2:

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

267. **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 SMEs that would assist SMEs 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).

268. 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-subsiary, 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 SMEs 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.

269. Staff acknowledge that some SMEs 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 SMEs 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.

Question 26.2A

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 should be considered to be the acquired business?

Question 26.2B

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?

Question 26.2C

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

270. **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
271. **Field tests.** No related comments.
272. **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’.

273. **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.

274. **Staff recommendation.** Staff believes that ED paragraph 26.9 is a cash-generating-unit approach without using that term. 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 ‘component of an entity’ and, therefore, 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.]

275. **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 SMEs all of the options that an entity has using full IFRSs.

276. **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 SMEs 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.

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

278. **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.
279. **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 SMEs 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.
280. In Issue G2 (Agenda Paper 9A for the May 2008 Board meeting), staff recommend the removal of the more complex accounting policy options for SMEs for simplicity and clarity. At that meeting, the Board decided that, in general, all accounting policy options in full IFRSs should be available to private entities. Staff therefore recommends that the four methods allowed in IAS 19.92–93A be allowed as accounting policy options in the IFRS for SMEs.

Question 27.1

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 SMEs?

Issue 27.2: Pensions – past service cost [Staff recommendation changed from Agenda Paper 9C May 2008.]

- 281. **Comment letters.** Allow deferral and amortisation of past service costs, in a manner consistent with what is permitted under IAS 19.
- 282. **Field tests.** No related comments.
- 283. **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.
- 284. **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.

285. **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 SMEs 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). Based on the Board's May 2008 decision that all options in full IFRSs should generally be available in the IFRS for SMEs, the staff recommendation in Issue 27.1 now is to include in the IFRS for SMEs 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 of the IFRS for SMEs 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.]

286. **Comment letters.** Measure as if all employees would retire as of the reporting date (that is, at current liquidation amount) based on current salaries.
287. **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 27.16 for defined benefit plans.
288. **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.
289. **Staff recommendation.** Staff recommend that an 'undue cost or effort' exemption should be added to the requirement to apply defined benefit accounting for SMEs. In other words, Section 27 should state that when sufficient information is not available without undue cost or effort to apply defined benefit

accounting to a post-employment plan that is a defined benefit plan, an 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. Staff feel that the current liquidation amount is an appropriate simplification and provides users with useful information. Adequate disclosure about the defined benefit plan should be provided to supplement the current liquidation amount.

290. 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 SMEs and may not be applied correctly unless specialists are used. Staff note that if the SME has 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 apply defined benefit accounting to a post-employment plan that is a defined benefit plan, an entity should measure the defined benefit obligation of that plan at the current liquidation amount using current salary information?

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

291. **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.
292. **Field tests.** See Issue 27.3.
293. **WG recommendation.** Most WG members would encourage the Board to seek simplify the calculation of defined benefit obligations.
294. **Staff comment.** The Board's decision on Issue 27.3 will affect the outcome of the Board discussion on this issue.
295. **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 for 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 method to be used.

296. 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 SMEs 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 SMEs 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 SMEs or full IFRSs but the basis of allocation should be disclosed?

Issue 27.5: Pensions – treat all multiemployer as defined contribution

297. **Comment letters.** Treat all multiemployer plans as defined contribution.
298. **Field tests.** No related comments.
299. **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 multiemployer plans as defined contribution.
300. **Staff comment.** The ED proposes that multiemployer plans be classified as defined contribution or defined benefit based on their terms. However, if sufficient information is not available to use defined benefit accounting, then an SME can use defined contribution accounting, with disclosure.
301. **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 entities.

Question 27.5

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]

302. **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.
303. **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 SMEs since SMEs do not prepare the necessary budgets/forecasts. A few field test entities

noted particular problems with tax loss carry forwards as the entities only prepared limited forecasts

- d. Problems determining tax rates where, depending on the level of profits of the year, the entity may use a “reduced rate” on part of or all its profits.
 - e. Difficulties understanding certain paragraphs, for example 28.17 on initial recognition and 28.25 on measuring deferred tax at the rates applicable to undistributed profits.
 - f. 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.
304. **WG recommendation.** WG members did not express a clear consensus on how SMEs should account for income taxes; however the majority felt that the requirements as proposed in the ED are too complex for SMEs. 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 SMEs often do not have accurate cash flow budgets.
305. **Staff recommendation.** Staff recommend that the taxes payable method is required for SMEs 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 SMEs. 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 SMEs for the following reasons:
- a. Deferred tax is an area that is not well understood by both preparers and users of SME financial statements. The deferred tax requirements may be applied incorrectly if they are not clearly understood. Also many users are 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 SMEs 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. SMEs 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. SMEs 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 SMEs on the grounds of cost-benefits, supplemented by suitable disclosures?

Section 29 Financial Reporting in Hyperinflationary Economies

Issue 29.1: Existence of hyperinflation (Section 29)

- 306. **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.
- 307. **Field tests.** No related comments as not relevant to any of the field test entities.
- 308. **WG recommendation.** Not discussed.
- 309. **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 SMEs 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 SMEs 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 SMEs, 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

- 310. **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.

311. **Field tests.** SMEs should not need to apply functional currency requirements since the presentation currency required by law is the local currency and it would be costly and unnecessary to keep financial statements in both the functional and presentation currencies.
312. **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.
313. **Staff recommendation.** Staff agree with the WG recommendations. Staff acknowledge that, in the unusual case where an SME's functional currency is not its national currency, presenting financial statements in the true functional currency would provide information about the enterprise 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 such an exemption. For SMEs, such an exemption would significantly reduce the costs without significantly reducing the usefulness of the information presented.

Question 30.1

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, SMEs 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

314. **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.
315. **Field tests.** No related comments.
316. **WG recommendation.** WG members would leave cumulative exchange differences in equity on disposal of a foreign operation.
317. **Staff recommendation.** Staff recommend that SMEs should be prohibited from recycling these foreign exchange differences due to the significant administrative burden needed to track such historical exchange differences. Staff do not recommend that SMEs 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 SMEs should reflect the requirements of IAS 1 (2007) *Presentation of Financial Statements*. This means that SMEs will be presenting a statement of comprehensive income, making recycling less of an issue.

Question 30.2

Does the Board agree with the staff recommendation that the ED should be amended to prohibit SMEs 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

318. **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 SMEs is issued.
319. **Field tests.** No related comments.
320. **WG recommendation.** Not discussed.
321. **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.
322. **Staff recommendation.** Staff recommend that the Exposure Draft of Amendments to IAS 24 is considered if finalised before the IFRS for SMEs is completed for the following reasons:
- 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 equally applies to non-publicly accountable entities in such jurisdictions. Reducing disclosure requirements is in line with the objective of simplification of requirements for SMEs.
 - 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.
 - The Proposed Amendments are intended to rectify some inconsistencies in IAS 24 and, hence, those inconsistencies should also be amended in IFRS for SMEs.

Question 33.1

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

Section 35 Specialised Industries

Issue 35.1: Agriculture – allow cost model as option

323. **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.

324. **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.
325. **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.
326. **Staff comment.** Paragraph 35.1 of the ED 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)...
327. **Staff recommendation.** Staff agree with the WG recommendations that the current approach in Section 35 provides appropriate simplification for an SME 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 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 SMEs that undertake agricultural activities say that they manage 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 SMEs 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 used appropriately.

Question 35.1

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 SMEs and that the current requirement to apply fair value measurement, with an ‘undue cost or effort’ criterion is a sufficient simplification for SMEs?

Section 36 Discontinued Operations and Assets Held for Sale

Issue 36.1: Eliminate held for sale classification

328. **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*, automatically triggering an impairment assessment and calculation.
329. **Field tests.** Several field test entities do not think that separate measurement requirements for discontinued operations and assets held for sale are necessary for SMEs as they are too burdensome and costly, with limited benefits. Some additional significant issues identified include:
- a. Difficult to identify cash flows connected with discontinued operations and assets held for sale.
 - b. Difficult to determine fair value less costs to sell for held for sale items, for example for certain buildings.
 - c. Difficult to determine when an asset should be classified as held for sale. More guidance is necessary.
330. **WG recommendation.** WG members felt there is no need for a held for sale classification for SMEs. Instead the impairment requirements in the individual sections of the IFRS for SMEs cover this. The only substantive difference would be continued depreciation of non-current assets held for sale.
331. **Staff recommendation.** Staff agree with WG recommendations 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 SME 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 the requirements for assets held for sale should be dropped from Section 36 and that holding an asset for sale should be added to Section 26 as an impairment indicator?

Issue 36.2: Discontinued operations – simplify or eliminate this disclosure

332. **Comment letters.** Simplify (or even eliminate) discontinued operations disclosures and restatements.
333. **Field tests.** See comments for Issue 36.1 above.
334. **WG recommendation.** WG members recommended that prior period financial statements not be restated to segregate a discontinued operation.
335. **Staff comment:** If both discontinued operations disclosures and held-for-sale classification are removed from the IFRS for SMEs, Section 36 can be totally eliminated.
336. **Staff recommendation.** Staff agree with the WG recommendations that, for SMEs, 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 SMEs since users of the financial statements of non-publicly accountable entities are not subject to the same level of scrutiny, for example by analysts, as financial statements of publicly accountable entities. Some SMEs will have limited resources to perform such a restatement.
337. Staff do not think the requirement to provide information on discontinued operations in the current year is too onerous since most SMEs' 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 SMEs.
338. 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 Section 5 *Income Statement*. Staff note that the definition of a discontinued operation currently refers to assets held for sale and so the definition may need to be rewritten.

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 Section 5 Income Statement?

Section 38 Transition to the IFRS for SMEs

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

339. **Comment letters.** The majority of respondents were happy with the approach in Section 38. However, a significant number of these suggested modifications. One modification suggested 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.

340. **Field tests.** No related comments.
341. **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.
342. **Staff recommendation.** Staff agree with WG recommendations since the IFRS for SMEs 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 SMEs should be included in Section 38.

Question 38.1

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 SMEs adopting the IFRS for SMEs for the first time?

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

343. **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.
344. **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 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.
345. **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’).
346. **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.

347. Whether an ‘undue cost or effort’ principle should be added wherever the IFRS for SMEs requires restatement was one of the general issues (G11) in Agenda Paper 9A for the May 2008 Board 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.
348. **Staff recommendation.** Given the Board’s decision on General Issue G11, staff recommend that an ‘undue cost or effort’ principle should not be added to the impracticability exemption in 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?

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

349. **Comment letters.** Relax the requirements to allow an entity to move to and from the IFRS for SMEs (maybe more than once). On the other hand, a number of respondents were concerned about entities switching between the IFRS for SMEs and another accounting framework more than once. Some said that this may be a matter left to each jurisdiction to decide.
350. **Field tests.** No related comments.
351. **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 SMEs, 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 SMEs more than one time.
352. **Staff comment.** ED Section applies only to a first-time adopter of the IFRS for SMEs. 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 SMEs more than once:
- a. The entity uses the IFRS for SMEs, switches to full IFRSs (either because it became publicly accountable or by choice) and subsequently is no longer publicly accountable (most likely a ‘delisting’) or no longer chooses to use full IFRSs and so wants to re-adopt the IFRS for SMEs.
 - b. The jurisdiction in which the entity is located requires or allows the IFRS for SMEs 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 SMEs. 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 SMEs is required or permitted, and the entity wants to re-adopt the IFRS for SMEs.

- 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 SMEs for smaller entities. Initially the entity is not above the ‘economically significant’ threshold and so uses the IFRS for SMEs. Subsequently it exceeds the jurisdiction’s size threshold for full IFRSs, and accordingly switches from the IFRS for SMEs to full IFRSs. Subsequently it falls below the ‘economically significant’ threshold and, by regulation or by choice, wants to re-adopt the IFRS for SMEs.

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

353. **Staff recommendation.** Section 38 does not prohibit an entity from adopting the IFRS for SMEs 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 SMEs 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?