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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: **May 2008, London**

Project: **IFRS for Small and Medium-sized Entities**

Subject: **Redeliberation – Issues Relating to Sections 1 to 10 in the ED
(Agenda Paper 9B)**

1. For the May 2008 Board meeting, the SME agenda papers are organised as follows:
 - **Agenda Paper 9** – Overview
 - **Agenda Paper 9A** – General Issues
 - **Agenda Paper 9B** – Issues Relating to ED Sections 1-10
 - **Agenda Paper 9C** – Issues Relating to ED Sections 11-38
 - **Agenda Paper 9D** – Recommendations of the Working Group
2. This agenda paper (Agenda Paper 9B) sets out issues relating to Sections 1-10 in the Exposure Draft (ED) of a proposed IFRS for SMEs. The issues are numbered sequentially in section order, so the first issue for Section 2 is Issue 2.1, 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.

Issue 1.1: Use by a subsidiary of a full IFRS company (Section 1)

3. **Comment letters.** Clarify use of the IFRS for SMEs by a subsidiary of a full IFRS entity. Specifically, if there are recognition or measurement differences in the IFRS for SMEs, can such a subsidiary use the recognition and measurement principles in full IFRSs but make only the disclosures required by IFRS for SMEs?

Those who favoured this view felt it would make consolidation easier by allowing the subsidiary to use the same recognition and measurement principles as its parent.

4. **Field tests.** No related comments.
5. **WG recommendation.** WG members generally did not have much sympathy for giving subsidiaries of full IFRS reporters an option to use the recognition and measurement principles in full IFRSs but make only the disclosures required by IFRS for SMEs. They felt it is not appropriate to give a special treatment only to a subset of the entities within the scope of IFRS for SMEs. The IFRS for SMEs should not allow any further mandatory or optional fallbacks to full IFRSs. The goal of developing an SME standard is to provide relief for all non-publicly accountable entities. Some WG members thought that the IASB may want to address this question separately in the context of full IFRSs.
6. **Staff comment.** Most of the recognition and measurement simplifications proposed in the ED are optional. There are only a limited number of mandatory recognition and measurement differences in the ED. The principal mandatory ones are:
 - a. Measuring finance leases at the fair value of the leased property (Section 19).
 - b. Measuring at fair value all grants relating to assets that will be carried at fair value through profit or loss (Section 23).
 - c. Measuring impairment at the fair value of the impaired asset – no value-in-use calculation (Section 26).
 - d. Recognising actuarial gains and losses in full in profit or loss when they occur for defined benefit plans (Section 27).
 - e. Recognising all past service cost immediately in profit or loss for defined benefit plans (Section 27).
 - f. Recognising deferred taxes on (i) initial recognition of assets and liabilities and (ii) undistributed earnings of domestic subsidiaries, branches, associates, and joint ventures.. (Section 28).
7. **Staff recommendation.** Those who favoured this proposal felt it would make consolidation easier because an SME would not have to change its accounting principles to those of its parent for the purpose of consolidation. However, the result would be, in effect, optional fallbacks to full IFRSs for a relatively small subset of entities eligible to use the IFRS for SMEs. The result would also be a hybrid set of accounting standards that is neither full IFRSs nor the IFRS for SMEs. That set of standards would differ for each such SME depending on the accounting policies chosen by its parent. The IFRS for SMEs is a package standard appropriate for non-publicly accountable entities, not a ‘pick and choose’ set of options. A subsidiary of a full IFRS entity can always choose to follow full IFRSs in its separate statements. Staff believe that if the Board wants to provide disclosure relief in full IFRSs for the separate financial statements of small subsidiaries of full IFRS parent entities, that could be done in full IFRSs.
8. Therefore, staff recommend the IFRS for SMEs not be changed to allow an SME subsidiary of an entity that uses full IFRSs to use the recognition and

measurement principles in full IFRSs (based on its parent's choice) but make only the disclosures required by IFRS for SMEs.

Question 1.1

If there are recognition or measurement differences in the IFRS for SMEs, does the Board agree with the staff recommendation that a subsidiary of an IFRS entity should not be allowed use the recognition and measurement principles in full IFRSs but make only the disclosures required by the IFRS for SMEs, in its published general purpose financial statements?

9. Staff note that a similar issue arises if an entity chooses the more complex option by cross-reference to an IFRS – in that case the full disclosures required by that IFRS are also required. The issue similar to the one above is whether some lesser set of disclosures should be required if the SME is a subsidiary of a full IFRS reporting entity? This problem would not arise if the Board agrees with the staff recommendation in Issue G1 in Agenda Paper 9A that the IFRS for SMEs be self-contained. If that were done, a complex option that is made available to an SME would be fully set out in the IFRS for SMEs, including disclosure requirements. In such a case, it may be appropriate to tailor those full IFRS disclosures for SMEs, and this would be assessed on a case by case basis.

Issue 2.1: Rewrite concepts and pervasive principles as clear guidance (Section 2)

10. **Comment letters.** Some of the pervasive principles in ED paragraphs 2.32 to 2.44 are more descriptive than prescriptive and, therefore, are not always helpful guidance. They should be rewritten to provide clearer guidance for an SME to decide on its appropriate accounting policy if the IFRS for SMEs does not specifically address a transaction, other event or condition.
11. **Field tests.** No related comments.
12. **WG recommendation.** WG members were supportive of the proposed Section 2 on concepts and pervasive principles, which they viewed as an essential component of a stand-alone IFRS for SMEs. WG members noted, however, that some of the pervasive principles are more descriptive than prescriptive, particularly the ones relating to subsequent measurement, and recommended the Board reconsider the descriptions for those to make them more prescriptive.
13. **Staff recommendation.** The pervasive principles in 2.31-2.44 are intended to help an SME decide on an appropriate accounting policy for a transaction or other event or condition that is not specifically addressed in the IFRS for SMEs. In the staff's judgement, the guidance for the accrual basis (2.33) and recognition (2.34-2.39) are clear principles-level guidance. Staff believe, however, that 2.40–2.44 could be rewritten to provide clearer guidance, as follows:
- a. 2.40: Clarify in this paragraph, or perhaps in a new paragraph, that the basic measurement model in the IFRS for SMEs is a historical cost, accrual-basis model, not a fair value model.
 - b. 2.40: Add a description of what is meant by 'historical cost'. That description should make clear that depreciation or amortisation of an asset is part of the historical cost model and is not a valuation of that asset. That description should also make clear that recognising an impairment loss by

writing an asset down to its fair value or net realisable value or other current measure is part of the historical cost model and does not mean a fair value model is being applied.

- c. 2.40: Explain that in the absence of cash consideration, fair value should be used as the basis for initially determining the historical cost of an asset, for example, assets acquired under a lease and assets acquired in a business combination, and this is part of the historical cost model, not a departure from it.
- d. 2.41: Dealt with in Issue 2.2 below.
- e. 2.42: Convert the last sentence, “Measurement of assets at those lower amounts is intended to ensure that an asset is not measured at an amount greater than the entity expects to recover from the sale or use of that asset”, which is descriptive, to more prescriptive guidance.
- f. 2.43: Restate as a principle that a non-financial asset shall not be measured at fair value unless the IFRS for SMEs specifically requires or permits this. Explain, further, that the only instance where this is required is for agricultural assets whose fair value can be reliably measured without undue cost or effort. The staff recommendation in (b) above (adding a description of the historical cost model) is relevant here as well.
- g. 2.44: The Board is currently debating whether a non-financial liability should be measured at an allocation of the consideration received or the best estimate of the amount required to settle the obligation at reporting date. A revised version of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is not expected to be released before 2009 and, hence, staff recommend that the IFRS for SMEs should retain the requirement in paragraph 2.44 which is that “Most liabilities other than financial liabilities are measured at the best estimate of the amount that would be required to settle the obligation at the reporting date”. However, staff would rewrite this sentence to be more prescriptive: ‘Liabilities other than financial liabilities should be measured at the best estimate of the amount that would be required to settle the obligation at the reporting date unless this Standard requires or permits a different measurement.’ Also, staff feel it would be useful to add to 2.44 the following: “Where the effect of the time value of money is material, the best estimate shall be the present value of the expenditures expected to be required to settle the obligation”.

Question 2.1

Does the Board agree with the staff recommendation that paragraphs 2.40 to 2.44 should be modified as outlined above (2.41 is dealt with in Issue 2.2 below)?

Issue 2.2: Concepts and pervasive principles – financial instruments measurement (Section 2)

- 14. **Comment letters.** In the pervasive principle in 2.41 (and again in Section 11), fair value should not be the default for all financial instruments. That is not the requirement of IAS 39.

15. **Field tests.** The single most problematic area highlighted by a high proportion of field test entities is annual determination of fair value where market prices or active markets are not available. The requirement to perform annual fair value measurements for common financial instruments was noted as complex, costly, and often not possible due to lack of reliable values and inability to bear necessary specialists' fees. .
16. **WG recommendation.** WG members felt that the measurement concepts as described in Section 2 (particularly 2.41 and 2.42) imply that fair value is the default basis of measurement for all assets under the IFRS for SMEs, with some exceptions for historical cost-based measurements. They felt that this view is reinforced because Section 11 on financial instruments is similarly written. WG members felt that Sections 2, 11, and perhaps others could be rewritten to give more emphasis to the historical cost requirements that are already in the ED.
17. **Staff recommendation.** Using fair value as the default in this paragraph, as well as in Section 11, suggests that the IFRS for SMEs requires more fair value measurement of financial instruments than does IAS 39. Rewriting of 2.41 will depend, in part, on whether and how Section 11 is rewritten. At a minimum, staff recommend that instead of saying "an entity generally measures financial assets and financial liabilities at fair value", 2.41 should include a general principle on when fair value is appropriate (such as when it is reliably measurable) and a general principle on when cost or amortised cost is appropriate.

Question 2.2

Does the Board agree with the staff recommendation that paragraphs 2.41 should be modified taking into account the issues outlined above?

Issue 2.3: Clarify the pervasive principles for fair value (FV) measurement (Section 2)

18. **Comment letters.** In the general principles for measurement in Section 2 clearly require measurement at cost if there is no objectively determinable or observable market price. In a similar vein, some letters would have an exception for all FV measurements when the measurement would involve 'undue cost or effort'. A number of letters would add principles for when FV is appropriate.
19. **Staff comment:** The same issue arose as a general comment on the ED and is dealt with in Issue G12 in Agenda Paper 9A.
20. **Staff recommendation.** No further recommendation here.

Issue 2.4: Objective – Stewardship (Section 2)

21. **Comment letters.** A sizeable number of respondents suggested that, in paragraph 2.1 (objective of financial statements of SMEs), 'show the results of management's stewardship' should be given more importance. Other letters proposed stewardship as a separate objective of SME financial reporting on par with decision usefulness.
22. **Field tests.** No related comments
23. **WG recommendation.** Not discussed.

24. **Staff comment.** The objective as stated in ED paragraph 2.1 is:
- The objective of financial statements of a small or medium-sized entity is to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. In meeting that objective, financial statements also show the results of management's stewardship of the resources entrusted to it.
25. **Staff recommendation.** As currently written, the objective in 2.1 is decision-usefulness, and reporting on stewardship is a consequence of providing decision-useful information. This is consistent with the Board's preliminary views on the objective of financial reporting as set out in the July 2006 Discussion Paper on the Board's *Preliminary Views on an Improved Conceptual Framework*. Paragraph OB28 of that Discussion Paper explains that "the objective of financial reporting stated in paragraph OB2 encompasses providing information useful in assessing management's stewardship."
26. However, the acknowledgement of stewardship in the objective as stated in ED paragraph 2.1 is different from stewardship as included in the IASB Framework as currently written, which states:
- 12 The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.
- [Paragraph 13 omitted]
- 14 Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the entity or whether to reappoint or replace the management.
27. The objective as written in the existing IASB Framework emphasises stewardship to a greater degree than in ED paragraph 2.1 by making it a goal additional to, rather than a consequence of, decision-usefulness. Staff recommend that the IFRS for SMEs should not anticipate changes to full IFRSs, including the change in emphasis of stewardship. Therefore staff recommend a change to the ED so that stewardship is presented as a separate part of the objective of financial statements of SMEs in a manner similar to the way it is presented in the existing IASB Framework.

Question 2.4

Does the Board agree with the staff recommendation that reporting on management's stewardship of the resources entrusted to it should be presented as a separate part of the objective of SME financial statements by incorporating paragraph 14 from the existing IASB Framework into the objective?

Issue 2.5: Qualitative characteristics – should they be organised in a hierarchy (Section 2)

28. **Comment letters.** Present the qualitative characteristics that are in 2.2 to 2.11 in a hierarchy similar to that in the IASB Framework.
29. **Field tests.** No related comments.
30. **WG recommendation.** Not discussed.
31. **Staff comment:** Under the Framework in full IFRSs, the hierarchy is as follows:

Qualitative Characteristics:

Understandability

Relevance

Materiality

Reliability

Faithful representation [this is not in SME ED because it is part of the definition of reliability rather than a separate characteristic]

Substance over form

Neutrality [this is not in SME ED because reliability is defined, in part, as freedom from bias, which is the same as neutrality]

Prudence

Completeness

Comparability

Constraints on relevant and reliable information:

Timeliness

Balance between benefit and cost

32. **Staff recommendation.** The qualitative characteristics of neutrality and faithful representation from the existing IASB Framework are not in the concepts in Section 2 to eliminate redundancy and possible confusion:
- a. faithful representation is clearly part of the definition of reliability (as explained in Issue 2.6), and
 - b. neutrality (meaning freedom from bias) is clearly part of the definition of reliability (as explained in Issue 2.8).

Staff believe that adding faithful representation and neutrality as separate qualitative characteristics would be redundant.

33. Those who favour adding a hierarchy believe it would provide added guidance on how the qualitative characteristics interrelate and guidance on how an entity should assess possible trade-offs. Those who do not see a need for a hierarchy believe that each of the qualitative characteristics in the IFRS for SMEs is equally important and does not overlap with another qualitative characteristic, and an entity must assess each one in deciding on its accounting policies. On balance, staff believe that the subtleties of a hierarchy are likely to be difficult for an SME to apply and, therefore, recommends no change in the ED.

Question 2.5

Does the Board agree with the staff recommendation that the qualitative characteristics of SME financial statements should not be organised in a hierarchy like the one used in the full IFRS Framework (that is, materiality as a sub-characteristic of relevance and substance over form, prudence, and completeness as sub-characteristics of reliability)?

Issue 2.6: Qualitative characteristics – neutrality (Section 2)

34. **Comment letters.** Add ‘neutrality’ until the IASB Framework is amended.
35. **Field tests.** No related comments.
36. **WG recommendation.** Not discussed.
37. **Staff recommendation.** The definition of neutrality in the IASB Framework is: “Freedom from bias of the information contained in financial statements.” The definition of reliability in the IASB Framework and in the IFRS for SMEs is: “Information has the quality of reliability when it is free from material error and bias...” Since reliability means freedom from bias, and neutrality also means freedom from bias, staff do not recommend the addition of a separate characteristic of neutrality.

Question 2.6

Does the Board agree with the staff recommendation that neutrality should not be added as a separate qualitative characteristic of SME financial statements?

Issue 2.7: Qualitative characteristics – full disclosure (Section 2)

38. **Comment letters.** Add full disclosure as a qualitative characteristic.
39. **Field tests.** No related comments.
40. **WG recommendation.** Not discussed.
41. **Staff recommendation.** The qualitative characteristic of completeness is defined in ED paragraph 2.8: “To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of relevance.” Staff believe that this covers what respondents to the ED meant by ‘full disclosure’. Staff do not see a benefit to adding full disclosure as a separate characteristic and, therefore, recommends that it not be added.

Question 2.7

Does the Board agree with the staff recommendation not to add ‘full disclosure’ as a separate qualitative characteristic of SME financial statements?

Issue 2.8: Qualitative characteristics – faithful representation (Section 2)

42. **Comment letters.** Add ‘faithful representation’ as a qualitative characteristic.
43. **Field tests.** No related comments.

44. **WG recommendation.** Not discussed.
45. **Staff recommendation.** The quality of reliability in ED paragraph 2.5 is defined as follows: “Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.” Thus, faithful representation is part of reliability. Staff recommend that it not be added as a separate qualitative characteristic.

Question 2.8

Does the Board agree with the staff recommendation that faithful representation should not be added as a separate qualitative characteristic of SME financial statements?

Issue 2.9: Qualitative characteristics – freedom from bias (Section 2)

46. **Comment letters.** Some comment letters suggested replacing ‘prudence’ with ‘freedom from bias’. On the other hand, some letters suggested retaining or emphasising prudence, since smaller companies often have weaker internal controls.
47. **Field tests.** No related comments.
48. **WG recommendation.** Not discussed.
49. **Staff comments.** 2.7, the paragraph discussing prudence states
Prudence is the inclusion of a degree of caution in the exercise of judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias.
50. **Staff recommendation.** Staff note that prudence is caution, subject to the constraint of freedom from bias. It is not the same thing as freedom from bias. In the qualitative characteristics in Section 2, freedom from bias is already included as part of the concept of reliability. Staff believe that prudence is a different concept and, therefore, recommend prudence should remain as a separate qualitative characteristic.

Question 2.9

Does the Board agree with the staff recommendation that prudence should be a separate qualitative characteristic and should not be replaced with freedom from bias?

Issue 2.10: Pervasive principles –subsequent measurement principle (Section 2)

51. **Comment letters.** Some letters questioned whether the pervasive subsequent measurement principles (2.41 to 2.44) are useful or whether subsequent measurement should only be discussed in individual sections of the IFRS for SMEs. (Note this contrasts with the comments highlighted in Issue G14 of Agenda Paper 9A, where it is noted in some letters that all general measurement

requirements should be in one place and only specific requirements should be in sections). Several respondents felt that 2.41 is a description but not a principle.

52. **Field tests.** No related comments.
53. **WG recommendation.** Not discussed.
54. **Staff recommendation.** The pervasive principles in 2.31-2.44 are intended to help an SME decide on an appropriate accounting policy for a transaction or other event or condition that is not specifically addressed in the IFRS for SMEs. The hierarchy in 10.2-10.4 requires an SME to look to those pervasive principles in the absence of more explicit guidance in the IFRS for SMEs. Measurement of assets and liabilities subsequent to initial recognition is a common problem encountered by SMEs, and the IFRS for SMEs cannot possibly cover all transactions, events, and circumstances involving subsequent measurement. Therefore, the staff recommend retaining pervasive subsequent measurement principles along the lines of those in 2.41-2.44. However, in Issue 2.1 above, staff have made some recommendations for changes to the proposed pervasive principles for subsequent measurement.

Question 2.10

Does the Board agree with the staff recommendation that pervasive subsequent measurement principles along the lines of those in 2.41 to 2.44 are useful and should not be deleted?

Issue 2.11: Pervasive principles – subsequent measurement: cash flow forecasts (Section 2)

55. **Comment letters.** Some letters proposed adding, as a principle for subsequent measurement, that an entity should choose a measure that helps the financial statement user forecast future cash flows.
56. **Field tests.** No related comments.
57. **WG recommendation.** Not discussed.
58. **Staff recommendation.** In BC24, the Board explained that forecasting cash flows is important to users of SME financial statements and, therefore, was an important consideration in deciding on the requirements of the IFRS for SMEs. Further, in BC120, the Board explained in deciding on the disclosure requirements of the IFRS for SMEs, the needs of users of SME financial statements for information about short-term cash flows, liquidity and solvency was critical. The proposal to add a pervasive principle for subsequent measurement that an entity should choose a measure that helps the financial statement user forecast future cash flows is consistent with the basis the Board used in deciding on the requirements of the IFRS for SMEs. Staff believes that such a principle could be helpful guidance for an SME that is trying to decide on an accounting policy for a transaction or other event or condition not specifically covered in the IFRS for SMEs. Therefore, staff recommend adding such a pervasive principle.

Question 2.11

Does the Board agree with the staff recommendation to add, as a pervasive principle for subsequent measurement, that an entity should choose a measure that helps the financial statement user forecast future cash flows because users of SME financial statements are particularly interested in information about short-term cash flows, liquidity and solvency as set out in the basis for conclusions?

Issue 2.12: Pervasive principles – measurement (Section 2)

59. **Comment letters.** A number of letters questioned why 2.31 only includes two possible measurement bases. They noted that the IFRS for SMEs permits or requires a number of bases other than those listed.
60. **Field tests.** No related comments.
61. **WG recommendation.** Not discussed.
62. **Staff comment:** 2.31 is part of the concepts in the IFRS for SMEs, which were taken from the IASB Framework. It is not one of the pervasive measurement principles. The IASB Framework says the following about measurement bases:
- 100 A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:
- (a) *Historical cost.* Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.
 - (b) *Current cost.* Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
 - (c) *Realisable (settlement) value.* Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.
 - (d) *Present value.* Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Because it is generally agreed that present value is not a measurement basis but a technique for measuring one of the other bases, the Board decided not to include it as a basic measurement concept in the IFRS for SMEs. Current cost, while mentioned in the Framework, is not used in standards; nor is replacement cost,

which most regard as synonymous with current cost. Realisable value is used in the context of inventories. The IFRS for SMEs uses ‘selling price less costs to complete and sell’.

63. **Staff recommendation.** Staff recommend expanding 2.31 to include any other measurement basis required in the IFRS for SMEs. Further, in its recommendation earlier in Issue 2.1 of this agenda paper, staff would expand the description of historical cost.

Question 2.12

Does the Board agree with the staff recommendation to describe other measurement bases required in the IFRS for SMEs?

Issue 2.13: Pervasive principles – fair presentation (Section 2)

64. **Comment letters.** Section 2 should describe or define what is ‘fair presentation’ for an SME and/or add fair presentation of financial statements as an objective.
65. **Field tests.** No related comments.
66. **WG recommendation.** Not discussed.
67. **Staff comment:** ED paragraph 2.1 states the following:

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

68. Fair presentation is already defined in the glossary and elaborated on in ED paragraph 3.1 as follows:

Fair presentation

Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in Section 2 *Concepts and Pervasive Principles*.

- (a) The application of this [draft] standard by SMEs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation of the financial position, financial performance and cash flows of SMEs.
- (b) As explained in paragraph 1.3, the application of this [draft] standard by an entity with public accountability does not result in a fair presentation in accordance with this [draft] standard.

The additional disclosures referred to in (a) are necessary when compliance with the specific requirements in this [draft] standard is insufficient to enable users to understand the effect of particular

transactions, other events and conditions on the entity's financial position and financial performance.

69. **Staff recommendation.** Staff recommend that a description of fair presentation not be added to Section 2 because it is already in paragraph 3.1 and is a defined glossary term. Instead, staff recommend that the words 'present fairly' be added to the objective of financial statements in ED paragraph 2.1 as illustrated below:

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

Question 2.13A

Does the Board agree with the staff recommendation that there is no need to describe 'fair presentation' in Section 2?

Question 2.13B

Does the Board agree with the staff recommendation that 'present fairly' should be added to the objective of financial statements of an SME as illustrated and also defined in the glossary?

Issue 2.14: Objective – tax and distributable income (Section 2)

70. **Comment letters.** Add determination of taxable income and distributable income as objectives (see BC28 to BC30).
71. **Field tests.** No related comments.
72. **WG recommendation.** Not discussed.
73. **Staff recommendation.** Those who support this recommendation point out that the tax authority is often a key user of an SME's financial statements. The Board acknowledges this in BC28 to BC30 but points out that the IFRS for SMEs is designed to produce general purpose financial statements (GPFS) – a defined term in the IFRS for SMEs glossary – not reports intended for the tax authorities. Financial statements that are designed to meet the reporting requirements of tax authorities are not GPFS. The measure of taxable income in a jurisdiction is a political decision made without regard to the definitions of asset, liability, income, and expense in a conceptual framework for financial statements. For the same reasons, financial statements designed to produce a measure of profit that corresponds to the legally distributable income under the law of a particular jurisdiction are not GPFS. Global accounting standards for SMEs cannot deal with tax reporting in individual jurisdictions. But profit or loss determined in conformity with the IFRS for SMEs can serve as the starting point for determining taxable income in a given jurisdiction by means of a reconciliation that is easily developed at a national level. A similar reconciliation can be developed to adjust profit or loss as measured by the proposed IFRS for SMEs to distributable income under national laws or regulations. The staff recommend, therefore, that

determination of taxable income and distributable income should not be added as objectives of general purpose financial statements of SMEs.

Question 2.14

Does the Board agree with the staff recommendation that determination of taxable income and distributable income should not be added as objectives of the financial statements of an SME?

Issue 2.15: User needs (Section 2)

74. **Comment letters.** Put more discussion of user needs in this Section. (Staff note that that it is now discussed in BC23 to BC26.)
75. **Field tests.** No related comments.
76. **WG recommendation.** Not discussed.
77. **Staff comment:** Here are those four paragraphs from the Basis for Conclusions:

Different users' needs and cost-benefit considerations

BC23 The Framework (paragraph 12) states:

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

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

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

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

trade-off should be assessed in relation to the information needs of the users of an entity's financial statements.

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

78. **Staff recommendation.** In Issue 2.11, the staff recommend adding a pervasive principle for subsequent measurement that an entity should choose a measure that helps the financial statement user forecast future cash flows. Staff do not recommend, however, moving most of BC23 to BC26 to Section 2 (or elsewhere in the body of the IFRS for SMEs) since it is supporting reasoning and belongs in the Basis for Conclusions.

Question 2.15

Does the Board agree with the staff's recommendations set forth in the preceding paragraph that (a) the pervasive principles for subsequent measurement should be linked to user needs (see Issue 2.11) but that (b) the discussion in BC23 to BC26 should not be moved into Section 2?

Issue 3.1: More standardisation of financial statement formats (Sections 3-8)

79. **Comment letters.** Require a more standardised financial statement format – too many options now. Be more prescriptive of sections, subtotals, minimum line items, and sequencing in financial statements, as well as note disclosures. SMEs and less-sophisticated users will find this kind of guidance especially helpful, and a common format will enhance comparability.
80. **Field tests.** Several field test entities are unsure of which line items to show on their balance sheet, for example, whether a subtotal for financial liabilities is needed or whether separate line items are needed for tax liabilities other than income taxes or for amounts due to related parties.
81. **WG recommendation.** WG members believe that the IFRS for SMEs should not prescribe financial statement formats, subtotals, minimum line items, sequencing, and note disclosures with more specificity than is proposed in the ED, as preferred formats vary across different jurisdictions and industries.

82. **Staff recommendation.** The ED proposes a limited number of sections, subtotals, and line items in each of the required financial statements. The ED also proposes certain minimum items that must be disclosed, in some cases on the face of a financial statement and in other cases either on the face or in the notes. Those who favour more prescriptive financial statement formats believe that SMEs would welcome this type of guidance because, in many cases, they lack the expertise to decide on the best format. They also believe that it will help users of SME financial statements understand and use those financial statements and to make comparisons between entities. Those who do not favour greater prescription than proposed in the ED believe that entities should have some flexibility to design their presentation to fit their circumstances (subject to the guidance in ED paragraph 10.2) and that prescription is undesirable due to differences in jurisdictional laws, industry norms, or local custom. Staff recommend that the IFRS for SMEs should not prescribe the financial statement formats, subtotals, line items, sequencing, and note disclosures with more specificity than proposed in the ED.

Question 3.1

Does the Board agree with the staff recommendation that the IFRS for SMEs should not prescribe financial statement formats, subtotals, minimum line items, sequencing, and note disclosures with more specificity than in the ED?

**Issue 3.2: Financial statement presentation – conform to IAS 1 (revised 2007)
(Sections 3-8)**

83. **Comment letters.** Conform to IAS 1 (revised 2007), including the new requirement for a statement of comprehensive income and a single format for the statement of changes in equity.
84. **Field tests.** No related comments.
85. **WG recommendation.** WG members disagreed with conforming the IFRS for SMEs to the requirements of IAS 1 (revised 2007). They believed that the requirements of the SME standard should be focused on presenting information to users of SME financial statements. In particular, they did not believe that those users demand a statement of comprehensive income or a ‘third balance sheet’. WG members supported the proposed requirements for an income statement and an equity statement with the option of a combined statement of income and retained earnings. Also WG members thought that the old financial statement titles – particularly balance sheet and income statement – will be better understood by SMEs and users of SME financial statements.
86. **Staff comment:** IAS 1 (revised 2007) requires:
- Present all non-owner changes in equity (that is, 'comprehensive income') either in (a) one statement of comprehensive income or (b) in two statements (a separate income statement and a statement of comprehensive income). Components of comprehensive income may not be presented in the statement of changes in equity.
 - Present a statement of financial position (balance sheet) as at the beginning of the earliest comparative period in a complete set of financial statements when

the entity applies an accounting policy retrospectively or makes a retrospective restatement to correct an error or for a reclassification.

- Disclose income tax relating to each component of other comprehensive income.
- Disclose reclassification adjustments relating to components of other comprehensive income.
- Changes the titles of financial statements (as they will be used in the IFRS for SMEs) as follows (but SMEs would be permitted to use other appropriate titles):
 - ‘balance sheet’ changes to ‘statement of financial position’
 - ‘income statement’ changes to ‘statement of comprehensive income’
 - ‘cash flow statement’ changes to ‘statement of cash flows’

87. **Staff recommendation.** Staff do not recommend requiring SMEs to prepare a statement of comprehensive income at this time. For one thing, the IFRS for SMEs does not have an ‘available for sale’ (AFS) classification of financial instruments for which the fair value change is recognised in equity (but see (d) below). Under the ED, the items of income or expense that can be reported directly in equity are:
- a. foreign exchange gains and losses on non-monetary items (Section 30); and
 - b. gain or losses on hedging instruments that effectively hedged variable interest rate risk of a recognised financial instrument; foreign exchange or commodity price risk in a firm commitment or highly probable forecast transaction; or a net investment in a foreign operation (Section 11).
 - c. changes in revaluation surplus if an SME elects the revaluation option under either Section 16 (PP&E) or Section 17 (intangibles).
 - d. if the option to use IAS 39 instead of Section 11 is retained, SMEs could have AFS instruments whose value changes are reported directly in equity and also additional gains or losses from other types of cash flow hedges.
88. Staff believe that these items are adequately covered by the disclosures required by paragraphs 11.51 for hedges and 30.26(b) for foreign exchange differences, and by the disclosure requirements relating to the revaluation and IAS 39 options, which support the proposed requirements for an income statement and an equity statement with the option of a combined statement of income and retained earnings.
89. Staff also do not recommend adding a requirement for a third balance sheet in the case of restatement. Disclosure of the restatement is required by paragraph 10.11 (change in accounting policy) and 10.23 (correction of a prior period error).
90. Staff do not make a recommendation here regarding the IAS 1 requirement for intra-period tax allocation. Rather, that will be addressed as part of the redeliberation of Section 28 *Income Taxes*.
91. Staff do not recommend adding a special requirement to disclose reclassifications, because accounting policies (glossary defined term) include the principles for

presenting financial statements, and a reclassification would be a change in accounting policy subject to the disclosure requirements of 10.11.

92. Staff recommend that the new titles for financial statements used in IAS 1 not be used in the IFRS for SMEs. The requirement proposed in ED paragraph 3.19, that an SME can use any titles as long as they are not misleading, would be retained.

Question 3.2

Does the Board agree with the staff recommendation that the IFRS for SMEs should not incorporate the above new IAS 1 (revised 2007) requirements?

Issue 3.3: Require standardised titles for the financial statements (Sections 3-8)

93. **Comment letters.** Require SMEs all to use standardised titles for financial statements, for example balance sheet, income statement, etc (ED paragraph 3.19 allows any that are not misleading).
94. **Field tests.** No related comments.
95. **WG recommendation.** WG members would not require SMEs to use standardised titles for financial statements.
96. **Staff recommendation.** Consistent with the staff's reasoning not to recommend requiring standardised formats for an SME's financial statements (see Issue 3.1 above), staff do not recommend that standardised titles be required.

Question 3.3

Does the Board concur with the staff recommendation that the IFRS for SMEs should not require standardised titles for financial statements?

Issue 3.4: Require two years of comparative prior period data (Sections 3-8)

97. **Comment letters.** Require two years of comparative data for SMEs, not just one (see ED paragraph 3.12).
98. **Field tests.** No related comments.
99. **WG recommendation.** Not discussed.
100. **Staff recommendation.** Those who support this recommendation feel that it provides more historical trend information. Those who do not support the proposal feel it adds to the burden of preparing financial statements, is more relevant for entities whose securities trade in public capital markets, and is not consistent with the requirement for an entity following full IFRSs. Further, under the ED an SME is not prohibited from providing two years of comparative data if it wishes to do so. Staff do not recommend requiring two years of comparative data.

Question 3.4

Does the Board agree with the staff recommendation that the IFRS for SMEs should not require two prior years of comparative data?

Issue 4.1: Liquidity presentation for the balance sheet (Section 4)

101. **Comment letters.** Do not allow liquidity presentation for the balance sheet (see 4.5 of the ED). SMEs are not able to assess relevance and reliability, as would be required by 4.5. Require a current/non-current presentation in all cases.
102. **Field tests.** No related comments.
103. **WG recommendation.** WG members recommended that a classified balance sheet should always be required, because SMEs are not in a position to assess reliability and relevance as proposed in ED paragraph 4.5, and also because financial institutions (principal preparers of unclassified balance sheets) are scoped out of IFRS for SMEs.
104. **Staff recommendation.** Staff recommend that all SMEs should be required to present a classified (current/non-current) balance sheet. The ED proposed that this would be the ‘benchmark’ unless an SME could demonstrate that a liquidity presentation provides reliable and more relevant information. Staff believe that making an assessment of relevance and reliability is problematic for most SMEs. Moreover, liquidity presentations are used primarily by financial institutions, and financial institutions would be prohibited from using the IFRS for SMEs anyway.

Question 4.1

Does the Board agree with the staff recommendation that the IFRS for SMEs should require a current/non-current balance sheet presentation?

Issue 4.2: Current/non-current distinction always 12 months (Section 4)

105. **Comment letters.** The current/non current distinction should always be made by reference to a period of 12 months. Some items (such as pension obligations) should always be classified as non-current liabilities – that is, the portion payable within 12 months should not be separated out.
106. **Field tests.** A few field test entities had difficulties in classifying items between current and non-current. Some field test entities said this was because their current information system is not adapted to produce certain information. It was noted that the illustrative financial statements could be edited to helpfully provide descriptions of the financial assets and liabilities in the balance sheet to assist classification of financial instruments.
107. **WG recommendation.** WG members recommended that the guidance and related definitions for the current/non current distinction as set out in ED paragraphs 4.6 to 4.9 should be retained. This would include continuing to classify as a current liability the portion of a non-current liability payable within 12 months.
108. **Staff recommendation.** While a 12 month distinction between current and non-current would probably be easier for an SME to apply, staff believe that the few exceptions in ED paragraphs 4.6 and 4.8 are needed to report the liquidity of some SMEs, in particular, those whose operating cycle is longer than 12 months and those that hold assets and liabilities primarily for trading but without a clear expectation of whether they will be traded before or after 12 months. Similarly, while simply including the current portion of a non-current liability within the amount reported as non-current might be easier for an SME, it would not be

consistent with the goal of providing users of SME financial statements with information that helps them assess the entity's short-term cash flows, liquidity, and solvency. Therefore staff does not recommend changing ED paragraphs 4.6 to 4.9.

Question 4.2A

Does the Board agree with the staff recommendation that the current/non-current distinction should not be based on realisation or settlement within 12 months?

Question 4.2B

Does the Board agree with the staff recommendation that the portion of a non-current liability payable within 12 months should be classified as a current liability?

Issue 5.1: Require analysis of expenses by nature (Section 5)

109. **Comment letters.** Require analysis of expenses by nature for all SMEs, for comparability and usefulness (see ED paragraph 5.8). Function is somewhat arbitrary and not comparable from company to company. If choice is retained, do not require disclosure of the additional information that ED paragraph 5.10 proposes (depreciation and amortisation expense and employee benefits expense) if function is chosen.
110. **Field tests.** There was a slight preference for the 'by function' presentation for the income statement in the sample of field test entities. However, both methods were widespread in the sample. Some entities noted that the 'by function' presentation of the income statement is impracticable due to the need to segregate distribution and administration expenses.
111. **WG recommendation.** WG members recommended keeping the choice between analysis by nature and by function (paragraph 5.8 of the ED). However, they recommended dropping the requirement in ED paragraph 5.10 that an entity using the function approach must also disclose depreciation (16.29(e)(v)), interest (11.48(b)), employee benefits (27.38(g) for defined benefit plans only), and taxes (28.28), because disclosure of this information is already required by other sections of the IFRS for SMEs.
112. **Staff recommendation.** Staff agree with the WG recommendation that the choice between analysis by nature and by function should be retained. Staff believe that the requirements of ED paragraph 5.10 are redundant and recommends that 5.10 be dropped.

Question 5.1A

Does the Board agree with the staff recommendation that the IFRS for SMEs should allow an SME to choose to present an analysis of expenses by nature or by function?

Question 5.1B

Does the Board further agree with the staff recommendation that the IFRS for SMEs should not require disclosure of additional information (including depreciation and amortisation and employee benefits expense) if an analysis of expenses by function is chosen (ED paragraph 5.10)?

Issue 5.2: Require separate income statement line item for changes in fair values (Section 5)

113. **Comment letters.** Require separate presentation of changes in fair values on the face of the income statement (if they are recognised in profit or loss).
114. **Field tests.** No related comments.
115. **WG recommendation.** Not discussed.
116. **Staff comments.** ED paragraph 5.3 requires only the following line items on the face of the income statement:
- (a) revenue;
 - (b) finance costs;
 - (c) share of the profit or loss of investments in associates and joint ventures accounted for using the equity method;
 - (d) tax expense;
 - (e) a single amount comprising the total of (i) the post-tax profit or loss of discontinued operations and (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and
 - (f) profit or loss.

ED paragraph 5.7 includes a list of components of income and expense that must be disclosed separately either on the face of the income statement or in the notes:

- (a) write-downs of inventories to selling price less costs to complete and sell, and the reversal of such write-downs;
 - (b) write-downs of property, plant and equipment to fair value less costs to sell, and the reversal of such write-downs;
 - (c) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
 - (d) disposals of items of property, plant and equipment;
 - (e) disposals of investments;
 - (f) discontinued operations;
 - (g) litigation settlements; and
 - (h) the reversal of other provisions.
117. **Staff recommendation.** Staff believe that changes in fair value of assets or liabilities that are recognised in profit or loss are additional examples of components of income and expense similar to those in paragraph 5.7 that are relevant to users of SME financial statements. Therefore, staff recommend that they should be presented separately either on the face in the income statement or in the notes. Staff do not recommend that such a line item should be required to be shown on the face of the income statement.

Question 5.2A

Does the Board agree with the staff recommendation to add ‘changes in fair values of assets or liabilities that are recognised in profit or loss’ to the list in ED paragraph 5.7?

Question 5.2B

Does the Board agree with the staff recommendation not to add ‘changes in fair values of assets or liabilities that are recognised in profit or loss’ to the list in ED paragraph 5.3 as a required line item on the face of the income statement?

Issue 6.1: Do not allow combined statement of income and retained earnings (Section 6)

118. **Comment letters.** Do not allow a combined statement of income and retained earnings (see paragraph 6.4 of the ED). Reasons given by respondents were not very strong; for example they included may lead to a lack of comparability and should not introduce a new statement that is not in full IFRSs.
119. **Field tests.** Of the field test entities complying with this section, about half preferred to present a statement of income and retained earnings instead of a statement of changes in equity.
120. **WG recommendation.** WG members favoured retaining the option for an SME to present a combined statement of income and retained earnings (see paragraph 6.4 of the ED). A jurisdiction could remove that option if it wishes.
121. **Staff recommendation.** Those who support allowing a combined statement of income and retained earnings believe that it is a genuine simplification for SMEs (one financial statement rather than two), easy to prepare, and readily understandable. Because providing an option to prepare a combined statement of income and retained earnings is a presentation option, a jurisdiction would be able to eliminate such an option and hence require that all SMEs prepare both an income statement and an equity statement. Staff recommend no change to the ED.

Question 6.1

Does the Board agree with the staff recommendation that a combined statement of income and retained earnings should be permitted?

Issue 6.2: Do not require a statement of changes in equity if the information is presented in the notes (Section 6)

122. **Comment letters.** Do not require either a statement of changes in equity or a statement of income or retained earnings under Section 6. Instead require appropriate information to be provided in a note disclosure.
123. **Field tests.** A few field test entities did not present a statement of changes in equity (or a statement of income and retained earnings) as many of them do not need to prepare such a statement under national requirements. Field test entities either did not provide reasons for this, said they did not see the need for such a requirement (and so presented the movements in equity in the notes) or noted that it would have been time consuming and burdensome to produce either statement (rather than too complex) especially since such preparation was only for voluntary

field testing purposes, rather than for statutory reporting. IASB staff feel that a few entities seemed to have simply been put off looking at Section 6, as they saw it as requiring a new primary statement, since most of these entities would qualify to prepare a statement of income and retained earnings, which would be relatively quick and easy. A few field test entities said their current information system is not adapted to produce a statement of changes in equity. One field test entity does not see the relevance of such a statement for their organisation.

124. **WG recommendation.** WG members supported retaining the requirement for a statement of changes in equity (or combined statement of income and retained earnings instead, if applicable), rather than providing this information in a note.
125. **Staff recommendation.** Staff agree with WG recommendations and, therefore, recommend retaining the requirement for SMEs to prepare a statement of changes in equity (or combined statement of income and retained earnings), rather than providing this information in a note. The objective of general purpose financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making decisions. An income statement and balance sheet would provide an incomplete picture of financial position and financial performance without being supplemented by a statement of changes in equity, for example because not all gains and losses recognised in the period are presented in the income statement. To present fairly the financial position and performance of the period, a statement of changes of equity needs to be given the same prominence as the income statement and balance sheet, rather than such information being provided separately, in a different format, within the note disclosures.

Question 6.2

Does the Board agree with the staff recommendation to retain the requirement to present a statement of changes in equity (or a combined statement of income and retained earnings instead, if applicable), rather than providing such information in a note?

Issue 7.1: Statement of cash flows – do not allow direct method (Section 7)

126. **Comment letters.** Remove the direct method for reporting operating cash flows (it is now a cross-referenced option).
127. **Field tests.** Only a small number of field test entities that produced a cash flow statement chose the direct method of reporting operating cash flows. Supporting reasons for choosing the direct method include it being easier based on available information, it being considered to give more relevant information (i.e., clearer where cash is coming from and going to) and the supervisory board requiring the direct method to be used. In addition, a few field test entities applying the indirect method specifically stated requirements for the direct method should be fully included in the IFRS for SMEs (not by cross-reference). A few field test entities said they had no choice but to use the indirect method as their current information systems would not be able to cope with the direct method.
128. **WG recommendation.** WG members would require all SMEs to present operating cash flows using the indirect method only as this appeared to be the method preferred by nearly all preparers and users.

129. **Staff recommendation.** Staff note that most lenders prefer the indirect method and most SMEs use it. In Agenda Paper 9A, staff have proposed removing all cross-references to full IFRSs and also eliminating accounting policy options. In this case, staff recommend that the direct method should not be an allowed option and that all SMEs should be required to present operating cash flows using the indirect method.

Question 7.1

Does the Board agree with the staff recommendation that all SMEs should present operating cash flows using the indirect method?

Issue 7.2: Statement of cash flows – exempt some or all SMEs (Section 7)

130. **Comment letters.** Exempt either all SMEs or small SMEs from the requirement to prepare a statement of cash flows, or allow jurisdictions to decide which entities are exempt from such a requirement under the IFRS for SMEs.
131. **Field tests.** A few field test entities did not present a cash flow statement. Most of those noted that currently they do not need to prepare such a statement under national requirements. The main reasons given for not presenting a cash flow statement are centred on the fact it is time consuming and burdensome to produce, rather than complex. Some field test entities decided it was not worth producing the cash flow statement for voluntary field testing purposes. A few field test entities said their current information system is not adapted to produce such information. A few field test entities did not prepare the operating cash flows section because they were not asked to produce comparative prior year information for field test purposes. Several field test entities acknowledged that the cash flow statement is important information for banks and other users. Very few field test entities specifically stated they cannot see the benefit of a cash flow statement.
132. **WG recommendation.** WG members supported retaining the requirement for a statement of cash flows.
133. **Staff recommendation.** Most lenders indicate that the statement of cash flows is important to them in making lending decisions. While some jurisdictions do not currently require SMEs to prepare a cash flow statement, it is not difficult to prepare. Staff acknowledge that the first time an SME prepares one, it might be time consuming, but it will be much less so in subsequent years. Staff do not believe that it should be left to an individual jurisdiction to decide whether to require a cash flow statement, because, in effect, that would be leaving to the jurisdiction the decision about what constitutes a fair presentation. The objective of financial statements of SMEs in ED paragraph 2.1 includes providing information about cash flows, so dropping the requirement would necessitate a change to the objective. Staff recommend that the IFRS for SMEs require a cash flow statement.

Question 7.2

Does the Board agree with the staff recommendation that a cash flow statement should be required?

Issue 7.3: Cash flow statement – income taxes always operating (Section 7)

134. **Comment letters.** Require that all cash flows from income taxes be operating.

135. **Field tests.** No related comments.

136. **WG recommendation.** WG members expressed mixed views regarding the requirement in paragraph 7.17 that cash flows relating to income taxes be classified as operating unless specifically identified with financial or investing activities. WG members did not support classifying all such cash flows as operating. On the other hand, WG members did not support a purely free choice of classification.

137. **Staff comments.** Currently 7.17 requires the following:

An entity shall disclose separately cash flows arising from taxes on income and shall classify them as cash flows from operating activities unless they can be specifically identified with financing and investing activities. When tax cash flows are allocated over more than one class of activity, the entity shall disclose the total amount of taxes paid.

Under 7.17, there is a presumption that income tax cash flows are operating. That presumption is overcome only when a tax cash flow can be specifically identified with financing or investing activities. Complex or arbitrary allocation, which could be burdensome for an SME, is not specific identification and, therefore, is prohibited by 7.17.

138. **Staff recommendation.** Those who support treating all income tax cash flows as operating argue that intra-period income tax allocation (that is, allocating some income tax cash flows to operating, investing, and financing activities) is arbitrary because tax effects of one type of activity often have consequences for another type of activity and depend, in part, on management intent. Staff believe that the solution in IAS 7, which is reproduced in ED paragraph 7.17, that income tax cash flows be presumed to be operating unless they can be clearly identified with investing or financing activities is a reasonable one that is not onerous for an SME to apply. Therefore staff recommend no change to the ED.

Question 7.3

Does the Board agree with the staff recommendation that the requirements in ED paragraph 7.17 should be retained, namely that cash flows from income taxes should be classified as operating unless they can be specifically identified with investing or financing activity?

Issue 9.1: Consolidation – reduce the requirements for all or some SMEs (Section 9)

139. **Comment letters.** Three types of proposals were made for reducing the proposed requirement that all small groups must prepare consolidated financial statements:

- a. Exempt smaller entities from the requirement to prepare consolidated financial statements.
- b. Allow jurisdictions to decide who prepares consolidated financial statements under the IFRS for SMEs.

- c. Establish criteria when consolidation should be required.
140. **Field tests.** Some field test entities are required to prepare consolidated financial statements under the ED; however quite a few of them chose not to do so (see comments below). Many of these field test entities said they do not need to prepare consolidated financial statements under their local GAAP. Hence, they would require assistance, for instance from their auditors, and several suggested more guidance and examples are required. A few field test entities said they did not prepare consolidated financial statements as it would have been too burdensome, but not many field test entities explained specifically what made them burdensome. Some field test entities envisaged problems due to different reporting dates and the need to apply uniform policies. Some specific reasons given for non-preparation include: (a) absence of reliable information, for example for a subsidiary in liquidation, and (b) subsidiary has not had significant transactions since incorporation so consolidated financial statements were not presented under local GAAP (full IFRSs) as it was considered it would cause undue delay.
141. **WG recommendation.** WG members would restrict – but not eliminate – the requirement that SME groups prepare consolidated financial statements. They recommend that the Board establish criteria for when consolidation should be required based on a user perspective. Examples of such criteria suggested were:
- a. Joint management.
 - b. Substantial intercompany transactions.
 - c. Borrowings of one entity secured by assets of the other
 - d. The group being managed as a single economic entity.
142. **Staff recommendation.** Those who support requiring consolidated statements for all SME groups – whenever there is a parent-subsidiary relationship – point out that, by definition, one entity controls the other. Therefore, how transactions (and therefore assets, liabilities, and profits) are allocated among entities in the group is not arm's length because the timing and pricing of those transactions can be controlled by the parent. In their view, only consolidated statements in which all assets and liabilities under control are combined and in which internal profits are eliminated will present fairly the financial picture of the group. Other respondents would not require consolidation in all cases. They point out that sometimes, even though there is a parent-subsidiary (control) relationship, the two entities do operate as independent entities. Moreover, they say that in some cases by law or contract, lenders and other creditors have recourse only to the assets of one of the legal entities. This group supports establishing criteria to identify relationships in which consolidated financial statements are necessary to provide a fair presentation of the group to users. Examples of such criteria are included in the Working Group recommendation above.
143. Some respondents – even if they feel that consolidation is conceptually the right answer – point out that preparing consolidated financial statements is somewhat burdensome. They say that consolidation may involve capturing information that is not normally included in either the parent's or the subsidiary's separate financial statements, and sometimes consolidation requires making complex adjustments to amounts reported in the separate financial statements. This group either would exempt small groups from a consolidation requirement altogether or

would reduce the circumstances in which consolidated statements are required purely as a practical simplification for SMEs.

144. Users of financial statements express mixed views on whether they want consolidated or separate company statements.
145. Staff recommend that the Board not require all SME groups to prepare consolidated financial statements but, rather, that the Board establish criteria for when consolidation should be required based on a user perspective. For other entities not meeting the criteria, consolidation would be optional – though a jurisdiction could require presentation of consolidated financial statements if it chooses. Such criteria could be when the group meets any one of the following:
- a. Substantial intercompany transactions.
 - b. Borrowings of one entity secured by assets of the other
 - c. The group being managed as a single economic entity.

Staff do not recommend a blanket exemption of entities at the smaller end of the SME scale from a requirement to prepare consolidated financial statements. Staff believe the exemption should be circumstance driven (based on criteria) and not size driven. Also staff do not recommend leaving it to individual jurisdictions to decide whether to require consolidated financial statements. This would mean that the jurisdiction, and not the IASB, decides what is a fair presentation.

Question 9.1

Does the Board agree with the staff recommendation to establish criteria for when consolidation should be required based on a user perspective, rather than require consolidated financial statements for all SME groups?

Issue 9.2: Consolidation – temporary control exemption (Section 9)

146. **Comment letters.** Allow a temporary control exemption from consolidation.
147. **Field tests.** No related comments.
148. **WG recommendation.** WG members generally did not support adding a temporary control exemption from consolidation because they felt that circumstances in which an SME would acquire a subsidiary with the intent to dispose are rare. Moreover, they believe that if consolidation is limited to circumstances in which defined criteria are met (see Issue 9.1 above), a temporarily held subsidiary would rarely if ever be consolidated.
149. **Staff comment:** IAS 27 has a footnote to paragraph 12 that states:
- * If on acquisition a subsidiary meets the criteria to be classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, it shall be accounted for in accordance with that IFRS.
- The IFRS for SMEs does not have a similar exemption.
150. **Staff recommendation.** Proponents of adding a temporary control exemption generally cite consistency with the requirement in full IFRSs as set out in the IAS 27 footnote. Staff do not recommend adding a temporary control exemption, for

the reasons cited by the WG members above and also because staff recommend the held for sale category be removed for SMEs (this is discussed in Agenda Paper 9C).

Question 9.2

Does the Board agree with the staff recommendation that a temporary control exemption should not be added to the requirements in Section 9?

Issue 9.3: Consolidation – only allow exemption if minority does not object (Section 9)

151. **Comment letters.** Only allow non-preparation of consolidated financial statements if the minority interest does not object. Non-preparation of consolidated financial statements could arise in two circumstances:
- a. the existing exemptions in ED paragraph 9.2. 9.2 provides an exemption when the SME parent is, itself, a subsidiary and its ultimate parent publishes consolidated financial statements that comply with full IFRSs or the IFRS for SMEs; and
 - b. the possible expanded exemptions if the staff recommendation to adopt criteria in Issue 9.1 is adopted.
152. **Field tests.** No related comments.
153. **WG recommendation.** WG members would not add a requirement that all minority shareholders must agree before consolidated statements are omitted.
154. **Staff recommendation.** Staff do not recommend adding a further requirement that all minority shareholders must agree before consolidated statements are omitted. Staff believe the documentation requirement would be burdensome. If the criteria approach proposed in Issue 9.1 is adopted, consolidated statements would be required or not required based on user needs, which staff views as a preferable approach to shareholder voting.

Question 9.3

Does the Board agree with the staff recommendation not to require that all shareholders agree (ie, that the minority interest does not object) before consolidated statements could be omitted?

Issue 9.4: Combined financial statements (Section 9)

155. **Comment letters.** Do not have requirements for combined financial statements (ED paragraphs 9.21-9.22). This is not a concept that is specific to SMEs, and it should be developed in full IFRSs first. Alternatively, some respondents suggested requirements for combined financial statements should be retained only if further guidance is provided.
156. **Field tests.** No related comments.
157. **WG recommendation.** WG members generally recommended that the guidance for combined financial statements (ED paragraphs 9.21-9.22) should be dropped.

This is not a concept that is specific to SMEs, and it should be developed in full IFRSs first.

158. **Staff recommendation.** Staff acknowledge that combined financial statements can provide useful insight when two or more entities are controlled by a single investor. At the same time, staff agree that this is not a concept that is specific to SMEs. Moreover, whether and how combined financial statements should be prepared relates to the Board's current Conceptual Framework project on defining the reporting entity. Staff have concluded that it may be premature and possibly oversimplified to address this issue in just two paragraphs in the SME standard while more comprehensive debate is going on in the Framework project. Therefore, staff recommend that the discussion of combined financial statements in ED paragraphs 9.21 and 9.22 be dropped.

Question 9.4

Does the Board agree with the staff recommendation that the guidance on combined financial statements in 9.21-9.22 should not be included in the final IFRS for SMEs?

Issue 9.5: Separate financial statements – accounting policies (Section 9)

159. **Comment letters.** Allow different accounting policies for categories of investments (for instance, one policy in accounting for associates in separate financial statements and a different policy in accounting for subsidiaries).
160. **Field tests.** No related comments.
161. **WG recommendation.** WG members supported retaining the requirement that an entity use only one single method as its accounting policy for all such investments.
162. **Staff recommendation.** ED paragraph 9.18 already allows an accounting policy choice – cost or fair value through profit or loss. This proposal would expand the choices further. By their nature, accounting policy choices reduce comparability between entities, and hence reduce understandability. This proposal would reduce comparability even within a single set of financial statements. Staff acknowledge that this is a departure from full IFRSs. However, staff do not recommend allowing different accounting policies for different categories of investments in separate statements.

Question 9.5

Does the Board agree with the staff recommendation that different accounting policies should not be allowed in accounting for different types of investments in separate financial statements?

Issue 9.6: Separate financial statements – equity and proportionate consolidation (Section 9)

163. **Comment letters.** Allow equity and proportionate consolidation methods in separate financial statements – not only cost or fair value through profit or loss. That is, the separate statements would mirror the treatment in consolidated financial statements to save time and explanations.
164. **Field tests.** No related comments.

165. **WG recommendation.** WG members generally would not change ED paragraph 9.18 by introducing additional methods of accounting for subsidiaries, associates, and joint controlled entities in separate financial statements. The choice between the cost method and fair value through profit or loss is appropriate and consistent with full IFRSs.
166. **Staff recommendation.** Staff do not recommend adding additional accounting policy choices to the two proposed in the ED, not only because the proposal in the ED is consistent with the requirements of full IFRSs but also because neither the equity method nor proportionate consolidation meets the test of a simple method appropriate for SMEs.

Question 9.6

Does the Board agree with the staff recommendation that the equity method and proportionate consolidation should not be allowed as added alternatives in separate financial statements to the extent allowed in consolidated financial statements?

Issue 9.7: Separate financial statements – require FV through P&L if there is an active market (Section 9)

167. **Comment letters.** If an active market exists, require fair value through profit or loss for investments in subsidiaries in separate financial statements.
168. **Field tests.** No related comments.
169. **WG recommendation.** WG members believe that the choice between the cost method and fair value through profit or loss is appropriate and consistent with full IFRSs. They would not add a requirement to use fair value through profit or loss if an active market exists.
170. **Staff recommendation.** Proponents of requiring fair value through profit or loss when an active market exists conclude that fair value is a more relevant measure of all financial instruments than historical cost, and if an active market exists the measure is sufficiently reliable to require SMEs to use it. Those who support the choice cite its consistency with full IFRSs plus the low probability that SMEs would have investments in subsidiaries whose shares trade in an active market. Staff support the latter view and recommends no change to the ED.

Question 9.7

Does the Board agree with the staff recommendation that fair value through profit or loss should not be required in separate financial statements if an active market exists for the subsidiary's shares?

Issue 9.8: Require separate financial statements (Section 9)

171. **Comment letters.** Preparing consolidated financial statements should not exempt entities from separate financial statements (that is, IFRS for SMEs should require both).
172. **Field tests.** No related comments.
173. **WG recommendation.** WG members supported the proposal in the ED not to require that separate financial statements be published in addition to consolidated

financial statements. WG members believed that this is a matter for each jurisdiction to decide.

174. **Staff comment:** Under ED Section 9 as currently written, when there is a parent-sub subsidiary relationship only consolidated statements are required – separate company statements are not required. Nor are they prohibited. Whether separate statements should be permitted or required, and whether they should conform to the IFRS for SMEs or to a national GAAP, is up to each jurisdiction to decide. This is similar to the approach under full IFRSs. Further, separate financial statements are part of the Board’s current reporting entity phase of the Conceptual Framework project.
175. **Staff recommendation.** Staff believe that this is a matter for each jurisdiction to decide and, therefore, recommends no change to the ED.

Question 9.8
Does the Board agree with the staff recommendation that the IFRS for SMEs should not require separate company financial statements when consolidated financial statements are prepared? That is, this is a matter for local jurisdictions to decide.

Issue 10.1: Accounting policies hierarchy (Section 10)

176. **Comment letters.** In the Invitation to Comment in the ED, there was a question on usefulness of the accounting policies hierarchy proposed in ED paragraphs 10.2 to 10.4. Approximately three-quarters of the comment letters addressing the issue supported the hierarchy proposed in the ED, although some of those respondents proposed slight amendments to clarify the requirements of these paragraphs. Nearly all the suggested amendments related to the need to state explicitly that there is no obligation to look back to full IFRSs. Comments include:
- a. Amend 10.4 to clarify that full IFRSs and pronouncements from other standard setting bodies can be considered ‘to the extent they do not conflict with the sources in 10.3’.
 - b. Revise 10.4 by replacing phrase ‘may also consider’ with ‘is not required, but may wish to consider’.
 - c. Revise the second sentence of 10.4 to commence ‘If further additional guidance’ to clarify it is not a mandatory fallback.
 - d. Delete the reference to full IFRSs in 10.4.
 - e. Revise 10.4 to clarify that full IFRSs is only one source of appropriate guidance similar to other GAAPs and accounting literature. 10.4 seems to introduce a hierarchy where SMEs must look first to full IFRSs and, only if additional guidance is needed, to other GAAP. Those who support this approach believe that this hierarchy may distract from properly applying 10.2 and 10.3 and cause the risk full IFRSs will be considered more than intended.
 - f. Some respondents proposed explicit clarification that an entity should give preference to full IFRSs over pronouncements of other standard setting bodies.
177. A few respondents would go further than just changing the wording in the hierarchy. They rejected the hierarchy altogether, as they felt that 10.2–10.4, plus

the numerous cross-references to full IFRSs and the close relation between full IFRSs and IFRS for SMEs, together constitute a *de facto* obligation to take recourse to full IFRSs.

178. In contrast, many of the remaining one-fourth of respondents who expressed reservations about the hierarchy did so because they felt that full IFRSs should be given more emphasis.
- a. Half of this group felt that if IFRS for SMEs does not specifically address a transaction, but full IFRSs does, then the entity should be required to look back to full IFRSs (in priority to applying 10.3). Some felt a fallback should always be required when specific detailed guidance for a particular type of transaction was missing; however others felt a fallback was necessary only if the IFRS for SMEs did not specifically address a particular transaction at all. This means that such respondents did not feel that SME-specific solutions derived from the concepts and principles in Section 2, or by analogy to similar issues addressed in IFRS for SMEs, should be allowed where there are specific requirements in full IFRSs. The effect of this approach would be to require SMEs to be knowledgeable about both the IFRS for SMEs and full IFRSs. The IFRS for SMEs would become simply guidance for an SME in applying IFRSs.
 - b. In addition, several other respondents said that while there should not be a mandatory fallback to full IFRSs, full IFRSs should be given priority over recent pronouncements of other standard-setting bodies. That is, full IFRSs should not be given priority over 10.3, but should be given priority in 10.4. This is different from a mandatory fallback to full IFRSs, as it still allows SME-specific solutions to be derived based on the concepts and principles in Section 2 or by analogy to similar issues addressed in the IFRS for SMEs.
179. **Field tests.** The hierarchy in 10.2 – 10.4 should clarify that accounting outcomes differing from full IFRSs are acceptable. Currently, some found it unclear whether SME specific solutions can be derived at all.
180. **WG recommendation.** WG members supported the hierarchy proposed in ED paragraphs 10.2 to 10.3. However, consistent with their view that the IFRS for SMEs should be fully stand-alone, WG members would eliminate paragraph 10.4 because they felt that 10.2 and 10.3 provide sufficient guidance and 10.4 may imply a fallback to full IFRSs.
181. **Staff comment:** Here are paragraphs 10.2–10.4 from the ED:
- 10.2 If this [draft] standard does not specifically address a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:
- (a) relevant to the economic decision-making needs of users; and
 - (b) reliable, in that the financial statements:
 - (i) represent faithfully the financial position, financial performance and cash flows of the entity;
 - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
 - (iii) are neutral, ie free from bias;

- (iv) are prudent; and
- (v) are complete in all material respects.

- 10.3 In making the judgement described in paragraph 10.2, management shall refer to, and consider the applicability of, the following sources in descending order:
- (a) the requirements and guidance in this [draft] standard dealing with similar and related issues; and
 - (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 Concepts and Pervasive Principles.
- 10.4 In making the judgement described in paragraph 10.2, management may also consider the requirements and guidance in full International Financial Reporting Standards (IFRSs) dealing with similar and related issues. If additional guidance is needed to make the judgement described in paragraph 10.2, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 10.3.

182. Staff considered whether the guidance in ED paragraph 10.2 for exercising judgment in choosing accounting policies constitutes, in substance, a hierarchy with just two qualities in the top of the hierarchy – relevance and reliability. Staff note that 10.2 is essentially taken word for word from IAS 8.10, while the IASB Framework has the hierarchy set out in the preceding paragraph. Both 10.2 and IAS 8.10 do not include understandability and comparability as criteria for selecting accounting policies. Staff concluded, therefore, that 10.2 is not a conflict with a possible hierarchy any more than IAS 8.10 is a conflict with the IASB.

183. **Staff recommendation.** Staff believe that 10.2 and 10.3 are equally appropriate in an SME context as in a full IFRS context, and perhaps more so given that topics in full IFRSs have been omitted in the IFRS for SMEs.

184. Further, staff do not believe that paragraph 10.4 should be eliminated in its entirety as it provides useful guidance to SMEs who are unable to reach a solution based on 10.2 and 10.3 alone and is consistent with the guidance provided in IAS 8. Staff recommend that 10.4 be reworded as follows to avoid the perception that 10.4 is a mandatory fallback to full IFRSs or the perception that full IFRS must be consulted before recent pronouncements of other standard-setting bodies can be consulted.

- 10.4 In making the judgement described in paragraph 10.2, management may, but is not required to, consider
- (a) the requirements and guidance in full International Financial Reporting Standards (IFRSs) dealing with similar and related issues; or
 - (b) the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices,

to the extent that these do not conflict with the sources in paragraph 10.3.

Question 10.1A

Does the Board agree with the staff recommendation that the hierarchy in 10.2 to 10.4 is appropriate in principle?

Question 10.1B

Does the Board agree with the staff recommendation to modify 10.4 as set out above?

Issue 10.2: Retrospective restatement only for fundamental errors (Section 10)

185. **Comment letters.** Require retrospective restatement (correction) only for ‘fundamental’ errors (some letters said ‘material’ errors).
186. **Field tests.** No related comments.
187. **WG recommendation.** WG members did not support requiring retrospective restatement only for ‘fundamental’ errors. ‘Fundamental error’ is not a defined term. WG members favoured adding ‘material’ to ED paragraph 10.20 to be consistent with IAS 8.
188. **Staff recommendation.** The word ‘material’ is a defined term. ‘Fundamental’ is not. Normally, the materiality qualification is not mentioned because it is universally applicable. Those who would add ‘material’ or ‘fundamental’ are concerned that without such a qualifier, entities might feel an obligation to correct all errors, no matter how small. Further IAS 8.42 uses ‘material’ – a decision the Board debated in its 2003 improvements to IFRSs. Staff recommend adding the qualifier ‘material’ to be consistent with the wording in IAS 8.

Question 10.2

Does the Board agree with the staff recommendation to add the word ‘material’ so that retrospective restatement (correction) is required only for ‘material’ errors (as in IAS 8)?

Issue 10.3: No retrospective restatement for accounting changes or error corrections (Section 10)

189. **Comment letters.** Do not require retrospective restatement for a voluntary change in accounting policy or for an error. SMEs do not have the data or the resources to do the retrospective restatements. Some letters would also not require SMEs to restate for accounting changes mandated by changes to the IFRS for SMEs, for the same reason as above.
190. **Field tests.** Adjustments to the financial statements due to errors relating to prior periods would be difficult to calculate due to the nature of our business and so disclosure would be the only solution, an example provided was that it’d be difficult to determine in which period the cause of a loss to agricultural produce arose.
191. **WG recommendation.** Not discussed.
192. **Staff recommendation.** The ED already proposes an impracticability exemption for disclosing the amount of an adjustment of a prior period for mandated

accounting changes (10.11), voluntary accounting changes (10.12), and error corrections (10.20). Staff recommend adding ‘without undue cost or effort’ to the impracticability exemption, but otherwise to keep the requirements for restatement (See Issue G11 of Agenda Paper 9A).

Question 10.3

Does the Board agree with the staff recommendation that retrospective restatement should be required for mandated and voluntary changes in accounting policy and for corrections of error (to the extent practicable without undue cost or effort plus disclosure of any impracticability)? (See also Issue G11 of Agenda Paper 9A for general discussion of undue cost or effort exemption from restatements.)